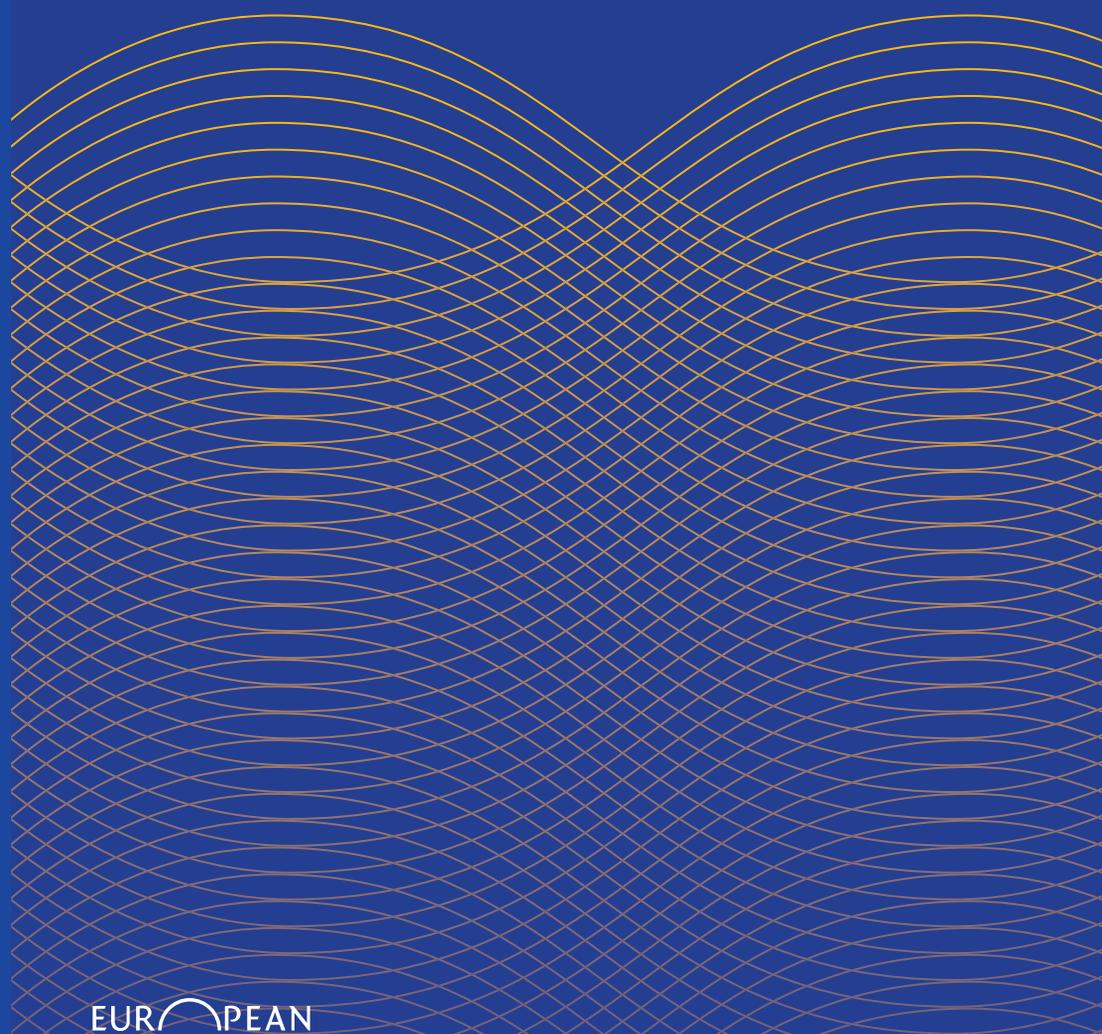


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European & Transatlantic Affairs



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REVIEW OF
European & Transatlantic Affairs

Introductory Remarks

1. 1. Editorial Letter from the Ambassador of the Federal Republic of Germany to the United States

Peter Wittig

Ambassador of the Federal Republic of Germany to the United States

2016 has been a year of crises: Our world seems to be in disarray. Our international order seems to be under siege. The belief that international integration and cooperation are the best response to overcoming global challenges has been called into question. Many people here in the US as well as in Europe increasingly perceive globalization as a threat to their physical, social, and economic security. Populism as well as extreme nationalism is on the rise again, calling for a rollback of the European Union. The last twelve months have not been business as usual – they have been a watershed. Thus, it is necessary and important to be clear-eyed about the challenges that evolved in this period which could shake the very foundations of our democracies and societies.

This edition of the 2016 Review of European & Transatlantic Affairs rightly addresses many of these challenges: For years, Europe has been grappling with low economic growth and high un-

employment. The need for structural economic reform remains. At the same time, Europe is facing challenges the likes of which have not been seen since World War II:

In our eastern neighborhood, Russia has illegally annexed the Ukrainian peninsula of Crimea and is directly involved in the conflict in the Donbass region. Apart from Ukraine, supporting many of our eastern partners on their path to economic and social stability and development of strong democratic institutions will remain a key priority.

The European Union's southern neighborhood - the Middle East and North Africa – remains highly unstable, with the raging civil war in Syria and the ISIL terrorist network as its most horrific reminders. At the same time, millions of Syrian refugees, along with many others from crisis regions, have fled economic, political, or social despair in their countries to seek a better life in Europe.

The consequences of these internal and external challenges are being felt everywhere in Europe. In these times, it is paramount that Europe finds common answers and deepens its alliances across the globe. The US and Europe, with our partnership based on our joint belief in democracy, human rights, and respect for the rule of law, have to close ranks. Germany, for its part, will stand up for this alliance to make it and Europe stronger.

I would like to congratulate the Review of European & Transatlantic Affairs on its latest edition, which brilliantly describes in-depth the rising challenges facing European democracies as well as foreign and economic policymakers. In doing so, it has immensely contributed to the public debate on re-focusing our transatlantic partnership. I hope the Review of European & Transatlantic Affairs and its contributors and readers will continue to engage in this much-needed discussion in the future.

Peter Wittig is a German diplomat and has been Germany's Ambassador to the United States since April 30, 2014.

1. 2. Featured Remarks by the Ex-Commissioner for Employment, Social Affairs and Inclusion of the European Commission

László Andor

Associate Professor at Corvinus University of Budapest

Senior Research Fellow at IMK (Hans Böckler Stiftung)

1. INTRODUCTION

Economic performance in Europe has been weak, and the resilience of the Economic and Monetary Union (EMU) has been tested in recent years. In this paper, we specify in what ways the European growth problems are special, and how EU level and national policies need to change to lead to better performance. While since 2013 GDP growth in most EU countries turned into positive, the eurozone is still in an unsustainable situation. This is a specific European weakness that delayed the recovery and keeps the EU in a more vulnerable position than either the US or Japan.

While the challenge of low growth is shared with most OECD countries, the European growth problem is aggravated by the limitations of the EMU and the low speed of its reform. Therefore, we first look into the implications of low growth for the EU, and the various policies promoting growth. We pay particular attention to the reform of the EMU and assess its chances in the aftermath of the Brexit referendum.

2. THE IMPLICATIONS OF LOW GROWTH IN EUROPE

The implications of low growth can be understood through the study of relative growth rates as opposed to overall economic performance or competitiveness. Based on the experience of the recent decade, we can observe the following:

- growth rates of BRICs have been higher than in OECD countries;
- within OECD: growth rates in the US have been higher than in Europe;
- within Europe: growth rates in the East have been higher than in the West;
- within Western Europe: growth rates in Germany have been higher than in France or Italy.

These trends can and should be analysed from the point of view of being benign or malignant. For example, less developed countries or regions catching up with the higher income countries is largely benign, both for the “global South” and the “European East”. On the other hand, slower growth in Europe as compared to the US economy since the 1990s can be seen as a matter of concern. And in particular, highly uneven growth rates within the eurozone together with divergent social outcomes and resulting political polarisation represent a malignant tendency which requires a closer look at the European context of growth.

In the EU, the contribution to (more and better) economic growth has been used to justify a variety of policies. Just to list a few:

- Shifting resources towards research, development and innovation (also within the EU budget);
- Improving the effectiveness of cohesion policy and industrial policy, and strengthening the link between the two for balanced growth;
- Negotiating trade and investment agreements with other countries of the world;
- Developing a social economy for inclusive growth;
- Promoting a circular economy for resource (and energy) efficiency and environmental sustainability;
- Developing banking union, capital markets integration and fiscal risk sharing for greater resilience of the EMU.

However, in order to see how exactly these actions contribute to economic performance, we need to break down the big question about growth into three smaller ones:

1. The long-term growth potential of the EU economy. In this respect, the EU is not much weaker than the US, and not

necessarily weaker than Japan (which also suffers from low growth). Emerging economies (Asian tigers, BRICs etc.) by definition experience higher rates of growth than OECD (migration of industrial jobs, hollowing-out of labour markets in advanced economies).

2. The short-term growth (recovery) capacity. In this respect, the EU (and especially the eurozone) is performing much worse than the US or Japan. Since 2011, the EU has decoupled from the rest of the OECD, due to the lack of counter-cyclical capacity/strategy within the EMU.

3. Balanced growth in the EU, i.e. the capacity to share prosperity among the participants of the single market and the single currency. This is a Treaty objective in Europe, but the recent experience is more about boom and bust in regions belonging to the “eurozone periphery”.

It is especially the eurozone periphery that suffered already immensely from the deep and long recession. While the harsh adjustment policies eventually resulted in some form of recovery, it also has to be recognised that an adjustment model based largely on internal devaluation (cuts in wages, pensions and public expenditures) undermines the capacity of convergence in terms of living and working conditions in the EU. This also has repercussions on the more competitive European economies in terms of weak demand, financial instability and unwelcome migration. The eurozone North (the financially stronger core countries) cannot any longer remain ignorant about the crisis of the South.

Of course, Europe cannot achieve very high growth rates in the foreseeable future (which would be comparable to the most dynamic emerging economies). But we cannot afford stagnation either. Given the existing trends of divergence, a Japanese style deflationary period would entail the risk of EMU (and consequently EU) disintegration,¹ together with the destruction of the

European Social Model.² Facing this perspective, since 2014 EU policies developed a new focus on investment.

3. EUROPE’S QUEST FOR INVESTMENT

The European Union has had a framework for growth, but it has been a cocktail of three loosely connected plans, rather than

¹ Stiglitz, Joseph E. (2016) *The Euro: How a Common Currency Threatens the Future of Europe*, WW. Norton and Company

² Dolvik, Jon Erik and Andrew Martin eds. (2015) *European Social Models from Crisis to Crisis. Employment and Inequality in the Era of Monetary Integration*, Oxford University Press

one integrated program.

First, a long-term strategy for smart, sustainable and inclusive growth (Europe 2020) was adopted in 2010. An annual cycle of economic governance (European Semester) was built around Europe 2020, which also functioned as orientation for the budget negotiations. The latter, unfortunately, ended with cutting, instead of increasing the EU budget for investment.

When the Eurozone economy entered the “second recession” in 2011, it was understood that the inherited (Maastricht) model has serious limitations,³ and intra-EU imbalances⁴ damage the recovery capacity of the EU as a whole. This can significantly weaken the long-term growth potential as well, and eventually threaten with disintegration. The need to deepen and complete the EMU became a daunting task.

Since 2012, the EU also had a vision for the reconstruction of the monetary union (the Four Presidents’ Report and Commission Blueprint), which, together with ECB interventions, contributed to short-term market confidence, but in terms of EMU reconstruction only resulted in the creation of a modest version of the Banking Union. Also in 2012, shortly after the French presidential elections, the EU adopted a Growth and Jobs pact, promoting capital increase for the EIB as well as innovative financial instruments like project bonds.

The assumption of this policy framework was that the rapid establishment of the Banking Union would make it possible to restore the flow of funds to the real economy, while the European Semester would help delivering crucial reforms for competitiveness. Thus, competitiveness would improve, enterprises would start investing again, and eventually growth and job-creation would return.

In 2014, it had to be recognized that while the Banking Union is a vital reform, it either does not happen with the necessary speed, or it does not lead to the right form of financing the economic recovery. There is a need to go beyond the minimalist Banking Union but, at least at this stage, there is no political momentum to put the Fiscal Union on the agenda. The investment plan is in between. It is an effort to overcome the depression through more intensive political coordination of investment activities, and a kind of credit rationing resources for this purpose,

3 De Grauwe, P. (2013) Design Failures in the Eurozone: Can they be fixed? LSE ‘Europe in Question’ Discussion Paper Series.

4 Regan, Aidan (2015) The imbalance of capitalisms in the Eurozone: Can the north and south of Europe converge? in. Comparative European Politics, March 2015

in the absence of a demand side stimulus.

In July 2014, investment was declared a priority by newly elected Commission President Jean-Claude Juncker. He identified one of the Vice-Presidents as the investment chief of the EU, and presented his investment plan to the European Parliament as early as November 2014.

According to the Juncker Plan,⁵ the EU provides €16 billion from its own budget, supplemented by an additional €5 billion from the European Investment Bank (EIB). With this seed capital, the European Fund for Strategic Investment (EFSD) hopes to attract almost €300 billion in private sector investment. Member States are also encouraged to contribute. Potential upgrading of the program has been often mentioned, especially since the 2016 September State of the European Union address by President Juncker.

Moving towards a “Juncker II” should allow for raising innovative ideas, like the establishment of a new vehicle (beyond or alongside EFSD), once the focus on equity support for enterprises is strengthened. In order to assist the growth of enterprises, identifying or creating a public equity agency at the European level could be a critical step forward. Such a public European investor would take minority equity stakes in medium-sized enterprises and thus help attract other investors on the market and improve companies’ access to both equity and debt.

4. FISCAL CAPACITY AND THE SOCIAL DIMENSION

The sovereign debt crisis since 2010 and the fiscal consolidation strategies implemented in response to it have substantially weakened the welfare state⁶ in peripheral Eurozone countries. In particular, they have weakened the effectiveness of so-called automatic fiscal stabilisers at the national level, which means the ability of a state to immediately act in a countercyclical way as tax revenues drop and social expenditure increases.

Unemployment increased to 11 percent in the EU and 12 per cent in the euro area in 2013, but it became twice as high on the Eurozone periphery. Unemployment amounted to a quarter of the workforce in both Spain and Greece in 2013, and youth unemployment rates peaked above 50 per cent in both. In these two

5 Andor, László (2015) Europe’s Quest for Growth, Prime Economics <http://www.primeeconomics.org/articles/europes-quest-for-growth>

6 See Vaughan-Whitehead, Daniel ed. (2015) *The European Social Model in Crisis: Is Europe losing its soul?* Edward Elgar

countries, income inequality (as measured by the GINI index) was already higher than the EU average before the crisis, and it continued to grow further in the crisis years.

In adjusting countries, where economic growth was negative and unemployment was on the rise in 2011-13, poverty has also risen significantly. Demand for the services of food banks has grown and many young people lacking opportunities choose to emigrate, often to other continents, which by definition results in a loss of human capital for Europe as a whole.

Such developments resulted in the adoption of a Communication on Strengthening the Social Dimension of the EMU by the European Commission (October 2013). In this document a scoreboard of key employment and social indicators was proposed. The scoreboard demonstrated that overall unemployment and youth unemployment and inactivity, along with income inequality and poverty, all showed significant and dangerous divergence⁷ during the crisis, especially inside the euro area.

Such trends underline the importance of the debate on Eurozone fiscal capacity.⁸ Out of various possible instruments, unemployment insurance stands out with its potential to tackle asymmetric shocks, cyclicalities and social dislocation. Two main directions for developing unemployment reinsurance have been explored: a partial pooling⁹ of national funds and a reinsurance¹⁰ mechanism. Both models can deliver three types of stabilization.

First, they would contribute to economic stabilization¹¹ by shifting demand and purchasing power to countries and regions which otherwise need to implement fiscal ‘adjustment’ and internal devaluation.

Second, social stabilization¹² would be enacted as well, by directing the flow of funds towards more vulnerable groups, and

7 European Commission (2014) Employment and Social Developments in Europe 2013, European Commission

8 Pasimeni, Paolo (2015). The Economic Rationale of an EMU Fiscal Capacity. Proceedings of the Oesterreichische Nationalbank Workshop “Towards a Genuine Economic and Monetary Union”. Vienna, September 2015.

9 Dullien, Sebastian (2014) A European Unemployment Benefit Scheme. How to Provide for More Stability in the Euro Zone, Gütersloh: Verlag Bertelsmann Stiftung

10 Beblavy, M., D. Gros and I. Maselli (2015) Reinsurance of National Unemployment Benefit Schemes. CEPS WD n. 401, Brussels

11 The stabilisation capacity has been proven by several independent studies, including: Brandolini, A., F. Carta and F. D’Amuri (2014), “A feasible unemployment-based shock absorber for the euro area”, *Questioni di Economia e Finanza (Occasional Papers)* No. 254, Banca d’Italia, Rome; and Dolls, M., Fuest, C., Neumann, D., & Peichl, A. (2014). An unemployment insurance scheme for the euro area? A comparison of different alternatives using micro data. A Comparison of Different Alternatives Using Micro Data (October 28, 2014). ZEW-Centre for European Economic Research Discussion Paper, (14-095).

12 Andor, László (2014) Basic European Unemployment Insurance - The Best Way Forward in Strengthening the EMU’s Resilience and Europe’s Recovery, *Intereconomics* Volume 49, July/August 2014, Number 4

helping to tame the rise of poverty among the working age population (which has been a major trend in recent years in Europe).

The third type is institutional stabilization. EMU is based on rules but the application of those has been the subject of academic and political debates. Member states agreed on tightening them but pragmatic considerations often lead to more flexibility. While some experts simply recommend giving up these rules entirely, it is more likely that a *modus vivendi* could be found through the creation of stabilization tools that would allow the reconciliation of uniform fiscal rules with the need to maintain national welfare safety nets and social investment capacities.

5. THE CASE FOR EMU REFORM AFTER BREXIT

The Slovak presidency of the Council (in the 2nd half of 2016) decided to discuss automatic stabilisers as a priority, while the outcome of the „Brexit referendum” in the UK created uncertainty about the way forward in Europe. Some claimed that the victory of Leave was a vote against the „detached Brussels technocrats” who should stop producing new ideas driven by the illusion of an ever closer union. This is, however, a typical wrong conclusion from a wrong analysis.

Brexit is largely a consequence of the democratic deficit and social divide within the UK itself. While both Labour and Conservative governments of previous decades were fairly successful in representing British interest in Brussels, they collectively failed in terms of ensuring that all regions and all social groups in the UK feel the benefits and the helping hand of the EU.

When the referendum was announced, popular anger against Westminster was diverted and turned against Brussels, while many voters did not know only two things: how the EU works and what Brexit means. Surveys have demonstrated that British people were the least knowledgeable in Europe about the functioning of the EU, and a variety of post-referendum letters, google searches and private confessions give further evidence to this.

The Brexit vote result sent shockwaves through Europe but, perhaps counter-intuitively, the first reaction in the public opinion was a shift towards the EU, and not away from it. This rise of EU popularity might be an outcry for stability, an expression of hope, but certainly not a proof of satisfaction with the status quo. This rise of confidence invites action from leaders, not least the European Council, that improves the economic and social sit-

uation and enhance the feeling of security in all countries in the short run but also improves the resilience of the EU economy in the long term. Otherwise the rise of anti-EU parties will just continue to a level when they can paralyse the European Parliament post-2019.

They already were boosted in 2014 and the counter-strategy of the time proved wrong. Instead of focusing on better performance, it focused on lightening the EU policy agenda, and especially legislation, driven by the belief that too much action at EU level irritates the citizens and fuels disaffection. This approach has been double wrong. First, it fails to distinguish between input and output legitimacy, and secondly, it tries to address the first purely through doing less instead of involving the citizens and various stakeholders more in democratic decision making.

Perhaps the biggest commonplace in Brussels is that the EU always develops through crisis. It is repeated so often and without the proper explanation of the causes of the crises that the listeners become complacent rather than alarmed. A new narrative is needed today to revitalise our debates as well as decision making. On the other hand, better communication will not automatically lead to better performance either. There should be no doubt that too much hesitation about joint action and a congestion of various crises on the agenda can destabilise the EU and push it towards disintegration.

Brexit should be a warning that voters can become impatient if leaders fail to address the key issues for a long time. And finding solutions to the key problems today is only possible through more cooperation. Germany cannot find solution to the refugee crisis alone, France cannot enhance security in a national context, and Italy cannot revive its economy purely through domestic reforms. In case of such a symmetrical despair, a grand bargain can emerge and make an EU deepening a win-win game.

6. CONCLUSION

Growth in Europe in recent decades has been weak and the recent recovery has been unimpressive too. However, slower recovery and growth in Europe as compared to the USA should only be one of our concerns. An even more important one is the lack of capacity to deal with substantial imbalances within the single market and the monetary union.

Eurozone imbalances necessitate a broader and more sub-

stantial EMU reconstruction, with the creation of a fiscal capacity. Unemployment insurance is a possible counter-cyclical fiscal instrument with a potential to improve economic performance and welfare state resilience at the same time. Through improving economic and social outcomes this would also help boosting the overall legitimacy of the EU project.

To increase long-term growth potential, European countries have to invest more and better in education, including early childhood education, lifelong learning, and active labour market policies. Financial instruments of the EU should be increasingly focused on such objectives.

Brexit should be a warning about the urgency to stop trends of disintegration stemming from uneven prosperity and the breakdown of social cohesion in various regions. While the causes and consequences of crisis are not felt evenly in different countries, progressive measures have been put on the table and the necessary political momentum for their implementation can also be created.

László Andor was Commissioner for Employment, Social Affairs and Inclusion in the Barroso II administration of the European Commission and is now an Associate Professor at Corvinus University of Budapest and a Senior Research Fellow at IMK (Hans Böckler Stiftung)

Democracy and Institutions

2. 1. The Euro 'Ideology' - What do the Policies Aimed at Rescuing the Euro Reveal about the State of the European Union?

SUBMITTED BY

Maurice Häfner

1. INTRODUCTION

The very first intention that the 1957 treaty establishing the European Economic Community (EEC), laid down, was that of an “ever closer union among the European peoples”.¹ An “ever closer” union implies irreversibility. Thus, irreversibility lies at the core of European integration.

Yet, at the height of the euro crisis, Mario Draghi, the president of the European Central Bank, felt the necessity to reassure the public that “the euro is irreversible”, and that the measures the ECB will take to preserve it “will be enough”.² This high-

¹ European Economic Community, “Treaty establishing the European Economic Community, “Republic of Turkey Ministry for EU Affairs, 1957, http://www.ab.gov.tr/files/ardb/evt/1_avrupa_birligi/1_3_antlasmalar/1_3_1_kurucu_antlasmalar/1957_treaty_establishing_eec.pdf.

² European Central Bank, “Verbatim of the remarks made by Mario Draghi,” European Central Bank, 2012,

lights the relevance of the euro crisis as it led to the challenging of core beliefs about European integration that used to be taken for granted. An analysis of this crisis, of the measures the EMU took to combat the crisis, and of how these measures were conceived, should thus allow an informative assessment of the current state of the European Union.

In order to keep the scale manageable, this analysis will focus on Greece, Ireland, and Germany on a national level. These three countries represent both the debtor (Greece and Ireland) and the creditor (Germany) countries the financial assistance programs created, and on the side of the debtors, they represent the crisis' whole spread. When it faced a public debt crisis, Greece became the first country to seek community loans and is still receiving assistance, while Ireland, when it faced a private debt crisis, became the second country to ever seek loans, and the first to complete its program.

2. CRISIS GENESIS AND EUROPEAN REACTION

The first questions this analysis will answer is how the crisis came to be and whether Europe managed to resolve its causes. The answers to the former question will be largely based on *'Rebooting the Eurozone: Step 1 – agreeing a crisis narrative'*, a paper authored by sixteen economists and published by the Centre for Economic Policy Research with the aim to “[formulate] a consensus on the causes of the [euro area] Crisis”.³ The paper identifies the stages of each crisis as the creation of imbalances, a trigger forcing these imbalances to retract rapidly, and a resulting sudden cease in lending. This chapter will be split accordingly.

When a state starts to face problems in servicing its debt payments, an easily employed and very old solution is to create new money to pay your creditors.⁴ However, this method creates inflation so that the payments the creditor receives and citizens' money holdings diminish in value. Accordingly, states with a history of employing this method have to pay more interest to re-

<https://www.ecb.europa.eu/press/key/date/2012/html/sp120726.en.html>.

- 3 Baldwin et al, “POLICY INSIGHT No. 85 November 2015 – Rebooting the Eurozone: Step 1 – agreeing a crisis narrative,” Centre for Economic Policy Research, 2015, <http://www.voxeu.org/sites/default/files/file/Policy%20Insight%2085.pdf>.
- 4 Reinhart, Carmen, Kenneth Rogoff. “This Time Is Different: Eight Centuries of Financial Folly.” Princeton: Princeton University Press, 2009, 174. Reinhart and Rogoff record: “Although inflation really became a commonplace and chronic problem only with the widespread use of paper currency in the early 1900s, students of the history of metal currency know that governments found ways to “extract seignorage” from the currency in circulation long before that. [...] Winkler gives [an example from] the fourth century B.C.”

ceive credit. In the 1920s, Germans experienced how the application of this method can reduce lifetime savings to nothing.⁵ The German precondition for joining the EMU was therefore that its regulations would preclude monetary financing of public debt.⁶

Accordingly, the Treaty on European Union (TEU) – which, *inter alia*, established the EMU – prohibited all forms of direct credit extension from the European System of Central Banks (ESCB, constituted by the ECB and national central banks) to any government, required national central banks to become independent from governments, and charged the ESCB with “price stability”.⁷ Without the possibility of ridding itself of debt by means of inflation, a government needs to ensure public debt remains sustainable. Therefore, the TEU also defined fiscal conduct rules known as Maastricht criteria and imposed that neither the European Community nor another state shall be liable for a member state.⁸ The latter part became known as the no-bailout-clause.

2.1. CREATION OF IMBALANCES

These measures to prevent inflation-based indirect defaults led to evaporating spreads between government bond yields within the EMU, with the introduction of the euro (see figure 1).

In the wake of this, a low yields for everyone climate – “big capital flows from [euro area] core nations like Germany, France [... to] periphery nations like Ireland, Portugal, Spain, and Greece” – occurred.⁹ In these countries, the incoming capital resulted in large national current account deficits. It was invested in “non-traded sectors like government consumption and housing”.¹⁰ Unsustainable government consumption led to soaring government debt ratios, as depicted in figure 2, and unsustainable housing price booms¹¹ built up enormous banking

5 Bresciani-Turroni, Constantino, “The Economics of Inflation: A Study of Currency Depreciation in Post-War Germany, 1914-1923,” London: Routledge, 2013, 441. Bresciani-Turroni notes that in between August 1914 and December 1923, the German currency was reduced to one trillionth of its worth.

6 Meurice, Jean-Michel, Jean Quatremer, “DIE ERFINDER DES EURO,” Strasbourg: Association relative à la télévision européenne, 2012, 18:00. In Meurice and Quatremer, Philippe Maystadt, the Belgian minister of finance at the time of the Maastricht negotiations, describes the Germans as “obsessed with the bugaboo of inflation” (Author’s translation: “Sie waren vom Schreckgespenst einer Inflation geradezu besessen”).

7 European Union, “TREATY ON EUROPEAN UNION, Feb. 7, 1992,” European Central Bank, 1992, https://www.ecb.europa.eu/ecb/legal/pdf/maastricht_en.pdf, Articles 104, 107-108, 105 (respectively).

8 *Ibid*, Articles 104c, 104b.

9 Baldwin et al., 1.

10 *Ibid.*, 4.

11 Reinhart, Carmen, Kenneth Rogoff, 207; Baldwin et al., 7. According to Reinhart and Rogoff, the American “housing price boom” that resulted in the global financial crisis of the late 2000s was the largest “in terms of sheer magnitude and duration” in recorded US history. The data provided by Baldwin et al. shows that the

industries, as depicted in figure 3. The incoming capital was not invested in anything that would produce sustainable income.

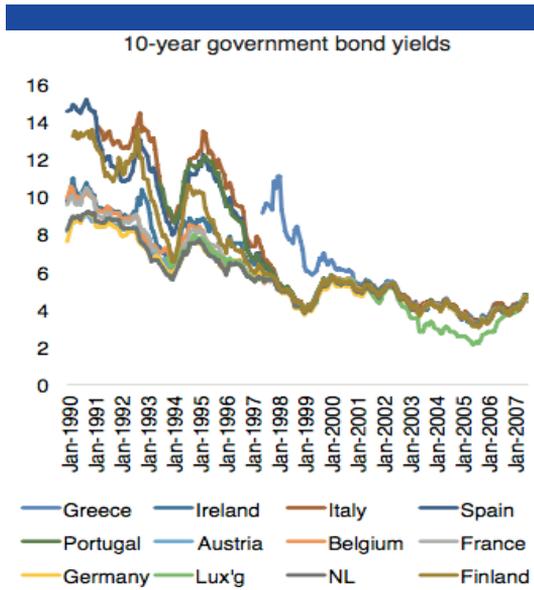


Figure 1: 10-year government bond yields.
Source: Baldwin et al.

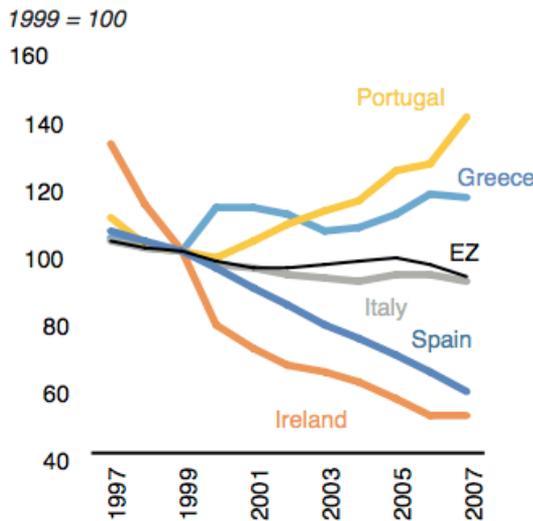


Figure 2: Debt-to-GDP ratios rebased to 1999.
Source: Baldwin et al.

housing prices in many European markets had inflated at an even steeper pace.

In these illustrations,¹² the imbalances were clearly perceivable as early as in 2004. This poses the question of why investors did not cut funding to public and private debt in countries such as Greece and Ireland until the crisis was triggered. The answer is that they considered losses impossible – in the countries that had built up private debt, the banks had grown to economy-dominating sizes. If they were to suddenly no longer be able to refinance themselves, their governments could not risk not saving them. In order to do this, a government would suddenly need a lot of debt capital. In such a scenario, the government would need to rule out bail-ins (meaning defaulting on parts of the privately held investments in the banks) to prove its own solvency. Defaults on public debt, on the other hand, were also considered impossible, as no one believed in the no-bailout-clause. According to Jörg Krämer, chief economist of the German Commerzbank, the common perception was, “Well, we can invest in Greece and if any problems pop up, in the end, other countries will bail out Greece.”¹³

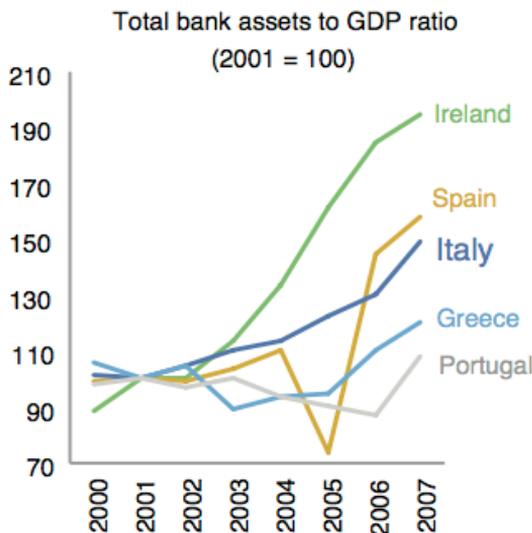


Figure 3: Total bank assets to GDP ratio.

Source: Baldwin et al.

¹² Baldwin, Richard, T. Beck, A. Bénassy-Quéré, O. Blanchard, G. Corsetti, P. de Grauwe, W den Haan, F. Giavazzi, D. Gros, S. Kalemlı-Ozcan, S. Micossi, E. Papaıoannou, P. Pesenti, C. Pissarides, G. Tabellini, B. Weder di Mauro. “POLICY INSIGHT No. 85 November 2015 – Rebooting the Eurozone: Step 1 – agreeing a crisis narrative.” Centre for Economic Policy Research. 2015. <http://www.voxeu.org/sites/default/files/file/Policy%20Insight%2085.pdf>.

¹³ Bristow, Jeremy, “Michael Protillo’s Great Euro Crisis,” London: British Broadcasting Corporation, 2012, 39:45.

The next question is how this public and private debt could have built up in spite of the European regulations pertaining to fiscal and monetary policy. As regards private debt, the answer is simply that no EMU rules and no common European supervision were in place to prevent asset boom-bust cycles. Regarding public debt, the answer is that in 2005, an amendment to the fiscal conduct rules created exception scenarios in which member states were allowed to breach the Maastricht criteria and extended deadlines to correct excessive deficits.¹⁴

2.1.1. EUROPEAN REACTION WITH REGARDS TO PRIVATE DEBT

In order to prevent unsustainable housing booms from occurring again, a European policy package called the six-pack extended the surveillance of member states' economic policies to current account balances.

Furthermore, financial supervision became integrated on a European level. First, the 2010 European System of Financial Supervision created two new European bodies tasked with “identifying and prioritizing systemic risks” in Europe’s financial markets, issuing warnings and recommendations with regards to these risks,¹⁵ “[settling] disputes among national financial supervisors”, and banning “risky financial products and activities”.¹⁶ Then, the single supervisory mechanism introduced as a part of the 2014 Banking Union (see below) made the ECB the authority responsible for European banking supervision, conducting the day-to-day supervision for the EMU’s most important banks¹⁷ and coordinating the supervision of the remainder of banks.

These measures decrease the possibility of undetected undesirable developments. The aggregated house price index for the EMU provided by Eurostat¹⁸ shows that house prices within

14 Council of the European Union, “Report, Subject: Improving the implementation of the Stability and Growth Pact.” Council of the European Union, 2005. <http://ec.europa.eu/councils/bx20050322/stab.pdf>.

15 Official Journal of the European Union, “REGULATION (EU) No 1092/2010 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board,” Official Journal of the European Union, 2010, <https://www.esrb.europa.eu/shared/pdf/ESRB-en.pdf>, Article 3.

16 European Parliament, “Parliament gives green light to new financial supervision architecture,” European Parliament, 2010, <http://www.europarl.europa.eu/news/en/news-room/20100921IPR83190/Parliament-gives-green-light-to-new-financial-supervision-architecture, 1>.

17 European Commission, “An important step towards a real banking union in Europe: Statement by Commissioner Michel Barnier following the trilogue agreement on the creation of the Single Supervisory Mechanism for the eurozone,” European Commission, 2013, http://europa.eu/rapid/press-release_MEMO-13-251_en.pdf, p.3. Those are defined as banks whose balance sheet size is larger than 30 billion euro or equal to “at least 20% of the home country’s GDP”.

18 Eurostat, “House Price Indices euro area and EU aggregates Index levels 2010 100 2016Q2,” Eurostat, 2016,

the EMU are still in (albeit at the end of) the process of reaching pre-crisis levels, suggesting a more sustainable growth pace. While the extent to which these measures prevent boom-bust-cycles will only be properly obtainable during the next European economic boom, they seem to be working for now.

Most importantly, though, due to the policy package called the Banking Union, investors are no longer absolved from their responsibility for bad investments. Instead of the respective states, the European financial assistance facility known as the European Stability Mechanism (ESM) has the role of recapitalizing important failing banks.¹⁹ As the ESM is backed by the entire EMU and its solvency is thus undoubted, it can afford the “bail-in of shareholders and creditors” in order to wind down failing banks “without recourse to taxpayers’ money”.²⁰

The significance of this last part is three-fold; on one hand, the Banking Union breaks the ‘doom loop’ – scenarios such as in Ireland, where the “government went down trying to save its banks”,²¹ can no longer unfold as easily. On the other, in the intertwined European financial markets, this arrangement means that EMU members no longer need to bail out other members to keep their own banks from harm. Finally, it restores investors’ responsibility for their investments.

All aspects considered, the reaction with regard to private debt can thus be viewed as quite successful. The picture is quite different, however, when public debt is concerned.

2.1.2. EUROPEAN REACTION WITH REGARDS TO PUBLIC DEBT

In order to combat unsustainable public spending, the supervision of all EMU members was increased; the European Semester introduced EMU members to the duty of incorporating advice given by the European Commission into their budget plans,²² the above-mentioned six-pack also makes it easier for

http://ec.europa.eu/eurostat/statistics_explained/index.php/File:House_Price_Indices_euro_area_and_EU_aggregates_Index_levels_2010_100_2016Q2.PNG.

¹⁹ European Stability Mechanism, “ESM direct bank recapitalisation instrument adopted,” European Stability Mechanism, 2015, http://www.esm.europa.eu/press/releases/esm_direct_bank_recapitalisation-instrument-adopted.htm.

²⁰ European Council, “Member states sign agreement on bank resolution fund, European Council,” European Council, 2014, http://www.consilium.europa.eu/en/press/press_releases/2014/05/pdf/member-states-sign-agreement-on-bank-resolution-fund/, 1.

²¹ Baldwin et al., 2.

²² Council of the European Union, “PRESS RELEASE 3030th Council meeting Economic and Financial Affairs,” Council of the European Union, 2010, https://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/116306.pdf.

the Commission to declare non-compliance with the EMU rules and introduces automatic sanctions,²³ the fiscal compact obliges its signees to introduce national legislation limiting governmental spending,²⁴ and the two-pack, inter alia, introduced a “common budgetary timeline” and empowers the Commission to request revisions of draft budgets.²⁵

The impact of these increases in supervision has been moderate. In its 2016 ‘Review of draft budgetary plans’, the Commission states “that only five of the sixteen draft budgetary plans are fully compliant with the [budget rules]”.²⁶ What this means is that the majority of the member states still reject subjugating themselves to the jointly stipulated EMU’s rules. This indicates that they do not feel obliged towards their peers and the joint project that is the EMU, and by extension, the EU.

Moreover, the EMU members have not dissuaded investors from betting against the no-bailout clause at all – in fact, they have encouraged it. EMU members which could no longer refinance themselves through the financial markets were indeed ‘bailed out’: To prevent their defaults, the solvent EMU members and the International Monetary Fund (IMF) have been providing coordinated loans, the disbursement of which is conditional on the recipient’s faithful implementation of an economic adjustment program. These programs consist of policy outcomes defined by the European Commission, the ECB, and the IMF, which is collectively known as Troika. Troika is also responsible for monitoring the implementation.

The first such program was the bilateral loans of 110 billion euros extended to Greece in May 2010, 30 billion of which the IMF financed, and the rest by the EMU member states.²⁷ Due to Greece’s admitted illiquidity, the rating agencies downgraded Greek treasury bonds to a level that did not fulfill the ECB’s minimum collateral requirements anymore, effectively leaving Greek banks cut off from central bank financing.²⁸ The ECB addressed

23 Council of the European Union, “Council confirms agreement on economic governance,” Council of the European Union, 2011, http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/124882.pdf.

24 European Council, “Fiscal compact enters into force,” European Council, 2012, http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/134543.pdf.

25 Official Journal of the European Union, “REGULATION (EU) No 473/2013 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 21 May 2013,” Official Journal of the European Union, 2013, <http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A32013R0473>, Articles 4 and 7.

26 European Central Bank, “Box 7 Review of draft budgetary plans for 2016,” European Central Bank, 2016, https://www.ecb.europa.eu/pub/pdf/other/eb201508_focus07.en.pdf?6d8bbe5e873e224eef9bbd6d92f600b4b, 1.

27 Eurogroup, “Statement by Eurogroup,” Eurogroup, 2010, <http://www.consilium.europa.eu/workarea/downloadAsset.aspx?id=27081>.

28 In order to borrow from the ECB, banks need to provide adequate collateral. Most banks use bonds issued by

this problem by deciding to drop 'program countries' bonds' minimum rating requirements.²⁹

By the time of the second bail-out (that of Ireland in November 2010),³⁰ the programs had already been institutionalized within the European Financial Stability Facility (EFSF), a special purpose vehicle that provided a lending capacity of 440 billion euro guaranteed by the EMU members, and also within the European Financial Stabilization Mechanism (EFSM), which added another 60 billion, guaranteed by the EU budget.³¹ Both instruments were designed as temporary solutions which raised the liquidity they provided by issuing securities themselves. Concerning the Irish loans, the EFSF provided 17.7 billion, and the EFSM 22.5 billion euro.³² In 2011, the EFSF's authorities were extended to action "on the basis of a precautionary program", intervention in "secondary markets"³³ and to the provision of credit enhancement.³⁴

The European bailout capabilities have continued to grow. In the meantime, the ESM, a permanent addition to the European institutions has absorbed the EFSF. Its lending capacity of 700 billion euro is guaranteed by the EMU members.³⁵

In 2011, Greek inability to conduct "a lowering of real wages and prices, fiscal adjustment and privatization at the same time", as Welter puts it,³⁶ led to a second round of loans extend-

the state they are located in for this purpose.

29 European Central Bank, "ECB announces change in eligibility of debt instruments issued or guaranteed by the Greek government," European Central Bank, 2010, <http://www.ecb.europa.eu/press/pr/date/2010/html/pr100503.en.html>.

30 Eurogroup, "Statement by Eurogroup and ECOFIN Ministers," Eurogroup, 2010, [http://www.consilium.europa.eu/press/press_releases/2010/11/pdf/Statement by the Eurogroup and ECOFIN-Ministers/](http://www.consilium.europa.eu/press/press_releases/2010/11/pdf/Statement%20by%20the%20Eurogroup%20and%20ECOFIN%20Ministers/).

31 Council of the European Union, "PRESS RELEASE Extraordinary Council meeting Economic and Financial Affairs," Council of the European Union, 2010, http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/114324.pdf. Both measures are introduced in this document.

32 Eurogroup, "Statement by Eurogroup and ECOFIN Ministers," Eurogroup, 2010, [http://www.consilium.europa.eu/press/press_releases/2010/11/pdf/Statement by the Eurogroup and ECOFIN-Ministers-28-11/](http://www.consilium.europa.eu/press/press_releases/2010/11/pdf/Statement%20by%20the%20Eurogroup%20and%20ECOFIN%20Ministers-28-11/).

33 Council of the European Union, "STATEMENT BY THE HEADS OF STATE OR GOVERNMENT OF THE EURO AREA AND EU INSTITUTIONS," Council of the European Union, 2011, <http://www.consilium.europa.eu/en/european-council/pdf/20110721-statement-by-the-heads-of-state-or-government-of-the-euro-area-and-eu-institutions-en.pdf>, 3.

34 Federal Ministry of Finance, "Chronology: Stabilisation of the Economic and Monetary Union," Federal Ministry of Finance, 2016, <https://www.bundesfinanzministerium.de/Content/EN/Standardartikel/Topics/Europe/Articles/2010-06-04-Chronologie-Euro-Stabilisierung.html>, 8.

35 Eurogroup, "Statement of the Eurogroup," Eurogroup, 2012, http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/129381.pdf.

36 Welter, Patrick, "Griechenland hängt ein Jahrzehnt am Tropf," Frankfurter Allgemeine Zeitung, 2011, <http://www.faz.net/aktuell/wirtschaft/eurokrise/rettungsfonds-griechenland-haengt-ein-jahrzehnt-am-tropf-11502897.html>. Author's translation: "Die Erfahrung aus dem Programm zeige, dass Griechenland nicht fähig sei, gleichzeitig eine große interne Abwertung, also reale Lohn- und Preissenkungen, die fiskalische Anpassung und Privatisierung zu leisten, heißt es." It should be noted that fulfilment of these three tasks at once would be troublesome for any economy, let alone one in a deep recession.

ed to Greece in 2012, for the amount of 93.5 billion euro.³⁷ This second program represents the only case where investors had to accept losses on their investments in European government-issued bonds.³⁸ However, the heads of the EMU member states highlighted that this was “an exceptional and unique solution” that was not going to find repetition.³⁹ After Syriza won the Greece parliamentary elections in early 2015 with “demands for a renegotiation of the bail-out program”,⁴⁰ Greece effectively suspended its program, prompting the ECB to lift its waiver of collateral requirements on Greek bonds.⁴¹ Again, market confidence in Greece evaporated, as figure 4 shows. A third financial and economic adjustment program with a volume of 86 billion euro was agreed upon in August 2015.⁴²

Overall, the EMU has made 780 billion euro⁴³ of loans available. Thereof, 17.7 were paid out to Ireland and 259.5⁴⁴ will have been paid out to Greece by the end of its current program. The EU has made 60 billion euro of loans available. Thereof, 22.5 were paid to Ireland and 7.16 were paid out to Greece as bridge financing in between the second and third program.⁴⁵

Some might argue that this assistance does not constitute an infringement of the no-bailout-clause, as it came in the form of loans. However, in these loan arrangements, the EMU creditors assume the risk of being liable for the commitments of the recipient state. This possibility is explicitly forbidden by the no-bailout-clause. European leaders themselves recognized that their compliance with the European treaties had been challengeable as they first initiated an amendment to explicitly allow the

37 “MEMORANDUM OF UNDERSTANDING BETWEEN THE EUROPEAN COMMISSION ACTING ON BEHALF OF THE EURO AREA MEMBER STATES, AND THE HELLENIC REPUBLIC,” European Council, 2012, http://ec.europa.eu/economy_finance/eu_borrower/mou/2012-03-01-greece-mou_en.pdf.

38 Eurogroup, “Eurogroup statement,” Eurogroup, 2012, <http://www.efsf.europa.eu/attachments/2012-02-21%20Eurogroup%20statement%20Bailout%20for%20Greece.pdf>, 2.

39 Council of the European Union, “STATEMENT BY THE HEADS OF STATE OR GOVERNMENT OF THE EURO AREA AND EU INSTITUTIONS,” Council of the European Union, 2011, http://www.consilium.europa.eu/en/european-council/pdf/20110721-statement-by-the-heads-of-state-or-government-of-the-euro-area-and-eu-institutions-en_pdf, 3.

40 The Economist, “Greece turns, Europe wobbles,” *economist.com*, 2015, <http://www.economist.com/news/europe/21640746-syrizas-victory-blow-european-austerity-it-may-also-be-blow-europe-greece-turns-and>.

41 European Central Bank, “Eligibility of Greek bonds used as collateral in Eurosystem monetary policy operations,” European Central Bank, 2015, <https://www.ecb.europa.eu/press/pr/date/2015/html/pr150204.en.html>.

42 Eurogroup, “Eurogroup statement on the ESM programme for Greece,” European Council, 2015, <http://www.consilium.europa.eu/de/press/press-releases/2015/08/14-eurogroup-statement/>.

43 First Greek bilateral loans of 80 billion, EFSF/ESM resources of 700 billion

44 first program 80, second program 93.5, third program 86

45 Council of the European Union, “EFSM: Council approves €7bn bridge loan to Greece,” Council of the European Union, 2015, http://www.consilium.europa.eu/press_releases_pdf/2015/7/40802201007_en_63573938700000000.pdf.

ESM's creation before they set it up.⁴⁶

The alternative to financial assistance would have been to let EMU members go bankrupt. At the beginning of the crisis, this would have brought the risk of further bank and national defaults within the EMU –here was no European common bank recapitalization tool in place yet, and the EMU's combined exposure to Greece and Ireland amounted to a staggering 558.5 billion USD in mid-2010.⁴⁷ Therefore, the decision for the original bailout programs is comprehensible. However, in 2015, when Greece had repeatedly and deliberately ignored the expiry dates of extensions it had received for its assistance programs,⁴⁸ and only 17% of Greek public debt remained in the hands of private investors,⁴⁹ the ESM could have recapitalized and/or wound down banks with Greek exposure and the EMU members' financial credibility regarding Greece or banks would no longer have been scrutinized by investors.⁵⁰ In other words, the EMU could have morally and financially afforded a Greek default.

Yet, instead of taking the chance to restore some confidence in the applicability of the EMU regulations, the European leaders chose to provide a third bailout program. Notably, this bailout does not preclude markdowns on Greek debt, as the IMF concludes in its 2015 analysis of the Greek public debt that only significant debt relief measures could render the Greek debt sustainable. Thus, the bailout choice provided only one advantage – a bankruptcy-induced Greek EMU exit⁵¹ could be avoided. In the conflict between the EMU's intended character and the goal of a European integration that is irreversible, Europe chose irreversibility.

2.2. CRISIS TRIGGER AND EUROPEAN REACTION

46 European Council, "Conclusions – 16-17 December 2010," European Council, 2011, http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/118578.pdf, 6.

47 BANK FOR INTERNATIONAL SETTLEMENTS, "BIS Quarterly Review December 2010," BANK FOR INTERNATIONAL SETTLEMENTS, 2011, http://www.bis.org/publ/qrtrpdf/r_qtr1012.pdf, 7. Exposure to Greece: Germany 65.4, Spain 1.3, France 83.1, Italy 6.8, rest of EMU 31.6; exposure to Ireland: Germany 186.4, Spain 17.7, France 77.3, Italy 24.7, rest of EMU 64.2

48 European Financial Stability Facility, "Extension of the EFSF programme and EFSF bonds for Greece," European Financial Stability Facility, 2014, <http://www.efsf.europa.eu/mediacentre/news/2013/extension-of-the-efsf-programme-and-efsf-bonds-for-greece.htm>. European Financial Stability Facility, "EFSF Board of Directors extends MFFA for Greece until 30 June 2015," European Financial Stability Facility, 2015, <http://www.efsf.europa.eu/mediacentre/news/2015/efsf-board-of-directors-extends-mffa-for-greece-until-30-june-2015.htm>.

49 Sbaili, Maxime, "Who Hurts Most If Greece Defaults," Bloomberg, 2015, http://www.bloombergbriefs.com/content/uploads/sites/2/2015/01/MS_Greece_WhoHurts.pdf.

50 Consider the difference between the 2015 yield spreads of the first 11 Eurozone (EZ) members and of the first 12 EZ members, which include Greece, in figure 4.

51 A bankrupt Greece would need to issue IOUs to its civil servants in order to pay them, and thus, create a new legal tender. This would not necessarily, but likely result in the state's exit from the EMU.

The bursting of the US housing bubble in 2007 prompted a “global financial panic.”⁵² In this environment of risk aversion in October 2009, the Greek government revised its previous estimate of the country’s fiscal deficit to 12.7% of GDP. In the euro crisis chronology issued by the German Federal Ministry of Finance, this doubling of the previously reported level marks the first entry,⁵³ Baldwin et al. consider it the crisis “trigger”.⁵⁴ Figure 4, a rendering of the yield spreads between the first eleven and twelve EMU members (the latter including Greece), depicts how this revision caused investors to lose faith in Greece and other EMU members.

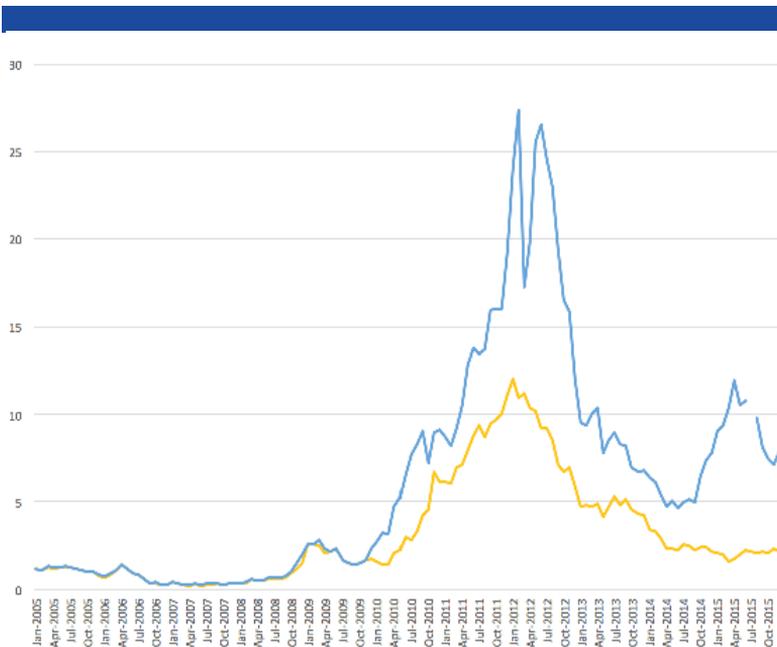


Figure 4: Eurozone Yield Spreads in Percentage Points.

Source: OECD, “Long term Interest Rates,” *OECD.Stat*,

<http://stats.oecd.org/Index.aspx?DataSetCode=KEI>. Monthly long-term interest rates.

European leaders reacted to this trigger by resolving on measures to increase financial credibility. When the Council of Ministers and the European Parliament passed the afore-mentioned six-pack policy package to reinforce the Stability and Growth Pact in November 2011, they made sure it established common minimum standards for accounting, data consistency and the provision of information. An entire directive was ded-

52 Reinhart, Carmen, Kenneth Rogoff, 208.

53 Federal Ministry of Finance, 1.

54 Baldwin et al., 7.

icated to this topic alone.⁵⁵ The two-pack, too, added further measures to increase financial transparency— it imposed a duty upon all euro area member states to base their budget plans on independent forecasts, to have their compliance with European “numerical fiscal rules” monitored by independent bodies, and even included a thorough definition of independence.⁵⁶

These measures document the impact that the abandonment of mutual rules has on a group because without them, each member ceases the ability to predict the actions of his peers. Then, the *modus operandi* of the group changes from interdependence and relying on each other to mutual distrust.

2.3. SUDDEN STOP AND EUROPEAN REACTION

The described trigger led to surging yields for some EMU members' bonds. These eventually reached heights that effectively cut the respective governments off from refinancing and prompted their requests for financial aid.

The bailouts – or financial and economic adjustment programs – extensively noted in chapter 2.1.2 were one attempt at rectifying this situation. When the Eurogroup announced agreement on the first program, it warranted its decision by arguing the program would “help restore confidence and safeguard financial stability in the euro area”.⁵⁷

The opposite was the case as the bailouts worsened the situation, as figure 4 depicts. In March 2010, the leaders of the euro area announced their readiness to provide “coordinated bilateral loans” given “[insufficient] market financing” in order to calm down markets with regards to Greece.⁵⁸ Instead, yields for other EMU members also began to surge. In May 2010, the Greek program was announced. Yields continued to rapidly increase. Investors took the bailouts for what they were – an admission that the European leaders were not confident enough in their banks and each other to allow defaults to happen.

Instead, the ECB brought the yields down. As mentioned at the beginning, Draghi announced in July 2012, “Within [its]

55 Official Journal of the European Union, “COUNCIL DIRECTIVE 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States,” Official Journal of the European Union, 2011, <http://eur.lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:306:0041:0047:EN:PDF>.

56 Official Journal of the European Union, “REGULATION (EU) No 473/2013 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 21 May 2013,” Articles 4.4, 5, and 2.

57 Eurogroup. “Statement by Eurogroup.”

58 Euro Summit, “STATEMENT BY THE HEADS OF STATE AND GOVERNMENT OF THE EURO AREA,” European Council, 2010, http://www.consilium.europa.eu/en/european-council/pdf/20100325-statement-of-the-heads-of-state-or-government-of-the-euro-area-en_pdf, 1.

mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough.”⁵⁹ The ECB substantiated this claim one month later, by announcing Outright Monetary Transactions (OMTs) under which the ECB may purchase, without “ex ante quantitative limits”, bonds issued by countries subject to an adjustment program on the secondary market, as long as these countries remain faithful to their program commitments.⁶⁰ Until today, OMTs have never been conducted. Yet, De Santis concludes that they largely eliminated the market’s concerns that the euro might break up.⁶¹ The restoration of pre-crisis yield spreads thus can be attributed mainly to OMTs, as Baldwin et al. agree.⁶²

In addition, the ECB has implemented a plenitude of asset purchasing programs it actually carried out. Those relevant to governmental lending costs are the Securities Markets Programme (SMP), under which the ECB has bought from the “euro area public and private debt securities markets”,⁶³ the Covered Bond Purchase Programmes (CBPP1-3), under which the ECB has been purchasing bonds issued by banks to refinance, among other things, purchases of public debt,⁶⁴ and the Public Sector Purchase Programme (PSPP), under which the ECB has been buying bonds “issued by euro area central governments, agencies, and European institutions in the secondary market”.⁶⁵ Assets from adjustment-program countries, which are sticking to their program-entailed commitments, are eligible in all of the ECB’s purchasing operations. In each of them, the ECB took precautions to limit the associated risks and its impact on market mechanisms.⁶⁶

Given that the ESCB’s direct credit extension to European governments is forbidden, the ECB can only purchase pub-

59 European Central Bank, “Verbatim of the remarks made by Mario Draghi.”

60 European Central Bank, “Technical features of Outright Monetary Transactions,” European Central Bank, 2012, http://www.ecb.europa.eu/press/pr/date/2012/html/pr120906_1.en.html, 1.

61 De Santis, Roberto. “Working Paper Series A measure of redenomination risk.” European Central Bank. 2015, <https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1785.en.pdf?3defd36b4dc6d5d7bc5d9d84188d464a>.

62 Baldwin et al., 11: “The rush to unload debt is driven by fear. The fear is driven by the suspicion that everyone else will sell the nation’s debt, thus driving borrowing costs up to the point where the nation goes broke. But if there is a debt buyer- of-last-resort – someone who can buy unlimited amounts – the suspicion dissolves and investors are happy to hold the debt. This is what Mario Draghi did in the summer of 2012. So far it has worked.”

63 European Central Bank, “ECB decides on measures to address severe tensions in financial markets,” European Central Bank, 2010, <https://www.ecb.europa.eu/press/pr/date/2010/html/pr100510.en.html>.

64 ECBC, “Introducing covered bonds,” ECBC, 2016, <http://ecbc.hypo.org/Content/Default.asp?PageID=504>.

65 European Central Bank, “ECB announces expanded asset purchase programme,” European Central Bank, 2015, https://www.ecb.europa.eu/press/pr/date/2015/html/pr150122_1.en.html.

66 Such precautions include minimum ratings, minimum issue sizes, maximum Eurosystem share of a given issue and purchasing only tranches which are not the first to bear losses.

lic debt on the secondary market. However, by stabilizing the secondary public debt market, purchasers in the primary market are provided with the safety of a liquid market to sell their purchases on. An increase in investment security means lower risk premiums, and thus, lower interest rates. Therefore, the ECB statement whereby buying bonds only on the secondary market “ensures that the ECB does not distort the market pricing of risk”⁶⁷ can be considered a blatant lie.

Figure 5, which depicts the spread between the Institutional Investor Credit Ratings⁶⁸ of the original 12 EMU members, corroborates this judgment. As the figure shows, the massive decline in yields to pre-crisis levels is by no means accounted for by a simultaneous return of credit ratings to pre-crisis levels. On average, the listed EMU members are still 10 percentage points short of the ratings they received a decade ago, and even without Greece, the lowest rating has plummeted to 57. So it is the ECB's interventions that keep the yield spread low.

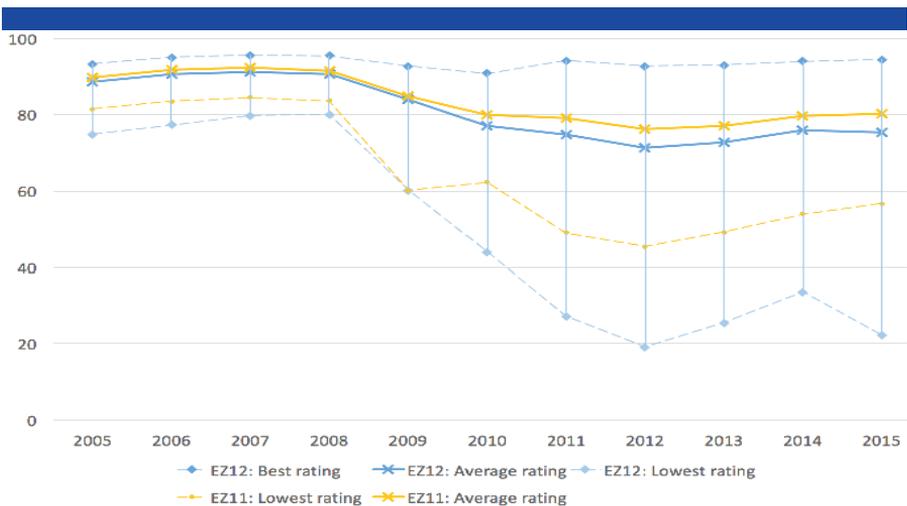


Figure 5: Euro area Institutional Investor Credit Ratings.

Source: Institutional Investor, “Overview,” Institutional Investor, <http://www.institutionalinvestor.com/Research/5500/Overview.html#.VtRRRcdtv4w>. September Rates.

Thus, the ECB is unquestionably helping states to refi-

67 European Central Bank, “What is the expanded asset purchase programme?,” European Central Bank, 2016, <https://www.ecb.europa.eu/explainers/tell-me-more/html/asset-purchase.en.html>.

68 Institutional Investor, “Methodology,” Institutional Investor, 2016, <http://www.institutionalinvestor.com/Research/5511/Methodology.html#.VtMOlsdtvSg>. “Institutional Investor’s Country Credit ratings are based on information provided by senior economists and sovereign risk analysts at leading global banks and money management and securities firms. The respondents have graded each country on a scale of zero to 100, with 100 representing the least likelihood of default. We weighted participants’ responses according to their institutions’ global exposure.”

nance themselves. In doing so, it is redistributing wealth: The McKinsey Global Institute has calculated that in between 2007 and 2012, the low interest rate environment has led to a cumulative loss in net interest income for the EMU banks, insurance, pensions, and households of 520 billion euro, while central governments and non-financial corporations have had a cumulative gain of 640 billion euro.⁶⁹ Since then, it is assumed that the effect has intensified itself, given that according to the Wu-Xia ECB shadow rate,⁷⁰ the asset purchasing programs have brought the effective EMU base rate to an unprecedented low (as depicted in figure 6).

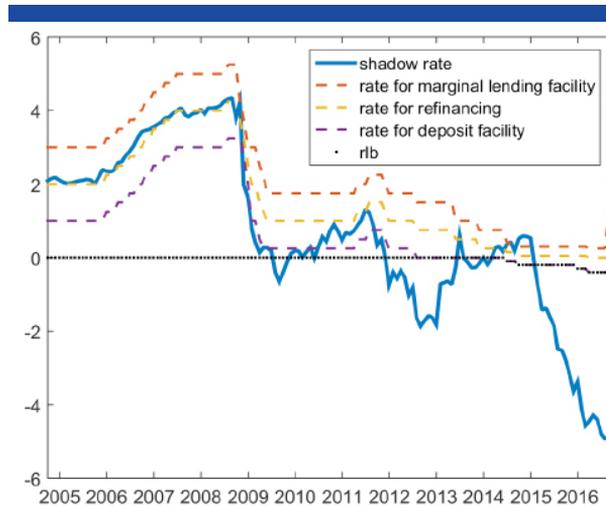


Figure 6: European Central Bank Shadow Rate.

Source: Wu, Jing Cynthia, Fan Dora Xia, "European Central Bank shadow rate," University of Chicago Booth School of Business, 2016, http://faculty.chicagobooth.edu/jing.wu/research/data/shadowrate_ECB.png

Therefore, while the ECB is not breaching the prohibition of direct credit extension to governments, it is conducting monetary financing at the cost of the private sector. In fact, it is carrying out precisely the kind of monetary policy it was designed to refrain from. Moreover, it is deceiving the general audience about this practice.

2.4. IMPLICATIONS

⁶⁹ McKinsey Global Institute, "QE and ultra-low interest rates: Distributional effects and risks," McKinsey, 2013, <http://www.mckinsey.com/global-themes/employment-and-growth/qe-and-ultra-low-interest-rates-distributional-effects-and-risks>, 13.

⁷⁰ Wu, Jing Cynthia, Fan Dora Xia. "Measuring the Macroeconomic Impact of Monetary Policy at the Zero Lower Bound." University of Chicago Booth School of Business, 2016, <http://faculty.chicagobooth.edu/jing.wu/research/pdf/WX.pdf>. The Wu-Xia shadow rate calculates which monetary base rate would be necessary to achieve the present market interest rates without any additional measures.

This completes the overview of the measures Europe took to manage the euro crisis. In summary, on one hand, Europe has successfully broken the dynamic of private debt crises cutting off their home states from market refinancing and managed to incorporate a process that bails investors in on the cost of saving banks. On the other, Europe has been incapable of fixing the cause of the public debt crises, and although fiscal monitoring was extended both in quality and quantity, the majority of member states still do not abide by the EMU rules designed to prevent unsustainable levels of government consumption. The fact that this cause remains unresolved, even though it brought the EMU to the brink of collapse, could suggest that the member states do not feel obliged towards the EMU as a common project.

However, the EMU's political and monetary leadership has established a framework of bailouts and indirect monetary financing that has kept the EMU alive at a tremendous cost as the European public deficits are essentially subsidized at the expense of financial markets and European households. Therefore, preserving the EMU (and along with it European integration) seems extremely important to Europe, and in the case of the ECB, important enough, in fact, to deceive citizens about the way it is being preserved.

What the inability to establish an obeyed regulatory regime for the EMU then actually represents is the lack of a true consensus over how a common European currency should work. This impression is reinforced by the fact that the mechanisms that have been effectively preserving the EMU since the height of the crisis are themselves undermining the bans (no bailouts and no monetary financing of public debt) most central to the EMU's originally intended character.

One must then wonder how a group whom the euro crisis has taught to distrust each other, and whose members disagree on what the group should be, has managed to convince national parliaments to ratify the measures the group took to preserve itself. After all, these measures demanded tremendous sacrifices from both creditor and debtor countries that had to be ratified at national level. The German ESM liabilities alone amount to 190 billion euro,⁷¹ and Greece and Ireland had to effectively cede large parts of their sovereignty.

⁷¹ Federal Ministry of Finance, 11: "Permanent representatives of the euro countries in Brussels issue a joint interpretative declaration which ensures, under international law, that the German Federal Constitutional Court's requirements concerning the ESM are complied with (the requirement that German liability is limited to €190bn [...])"

3. GENESIS OF BAILOUT PROGRAMS

In order to answer this question, this chapter will investigate how Greece and Ireland entered their programs, and how Germany entered its respective commitments.

3.1. STIFLING OF DEBATE

In September 2011, the German parliament decided upon the extension of German EFSF guarantees. The president of the parliament, Norbert Lammert, decided to provide two members of the government parties who were opposed to the extension with a chance to speak. As a German newspaper reports, both the head and the director of the largest parliamentary group went on to criticize Lammert for this decision.⁷² As the most harmless example, this event nevertheless documents the unwillingness to put a decision concerning European integration up for true debate.

Within the context of the same decision, Wolfgang Bosbach, a member of one of the German government parties that had openly stated he would vote against the extension, reported that his fellow party and parliamentary group members took this as a cause to accuse him of being anti-European and intellectually incapable of recognizing the importance of European unification.⁷³ The chief of the German Chancellery told Bosbach he wanted to neither see nor hear him anymore, in very offensive terms.⁷⁴ Moreover, deviants were removed from the parliament's influential committees.⁷⁵ All this demonstrates very well how instead of trying to convince opponents through arguments, and instead of seeking consensus, the measures' backers tried to bully the opposition into a positive vote by means of defamation and insults.

This treatment of fellow party members is especially concerning given that polls show the opponents were representing the overwhelming German majority, which had been opposed

⁷² Hamburger Abendblatt, "Redezeit für Abweichler – Lammert in der Kritik," Hamburger Abendblatt, 2011, <http://www.abendblatt.de/politik/articler108121094/Redezeit-fuer-Abweichler-Lammert-in-der-Kritik.html>.

⁷³ Hamburger Abendblatt, "Rettungsverweigerer Bosbach beklagt Druck aus der CDU," Hamburger Abendblatt, 2011, <http://www.abendblatt.de/politik/article108121493/Rettungsverweigerer-Bosbach-beklagt-Druck-aus-der-CDU.html>.

⁷⁴ Müller, Peter, "Druck auf Abweichler: Euro-Rettung vergiftet Klima in der Union," Spiegel.de, 2011, <http://www.spiegel.de/politik/deutschland/druck-auf-abweichler-euro-rettung-vergiftet-klima-in-der-union-a-789501.html>.

⁷⁵ Junge Freiheit, "Griechenland-Rettung: CDU-Abweichler packen aus," Junge Freiheit, 2015, <https://jungefreiheit.de/politik/deutschland/2015/griechenland-rettung-cdu-abweichler-packen-aus/>.

to every financial assistance package agreed upon by this point. The Germans did not want to provide the first loans to Greece without investor bail-ins⁷⁶ and they generally rejected German participation in the EFSF.⁷⁷ Most importantly, with regard to the above-mentioned treatment of deviants, the Germans explicitly did not want to extend the EFSF guarantees⁷⁸ while clearly identifying themselves as supportive of common European policies,⁷⁹ and rendering the anti-European labeling of bailout opponents as defamation.

In Greece, similar events occurred – when the government presented a bill to enter the state into the second program in February 2012, forty members of the government coalition voted against the deal. Consequently, their parties expelled them.⁸⁰ Similar to Germany, by doing this, they expelled the only party members that were representing public opinion; an overwhelming majority had been against the measures implied in the first program,⁸¹ and an enormous 82% of Greeks surveyed in July 2011 had stated they believed their country was heading in the wrong direction.⁸²

This establishes a pattern: within the ratification processes concerning policies meant to preserve European integration, governments, knowing they were acting against the people's explicit will, established a climate in which different approaches to solving the problems at hand did not have permission to be evaluated. Instead, those people's representatives who had opposed the decisions that had been made for them on a European level were insulted, and their careers crippled.

Just like the bailouts and the indirect monetary financing of public debt conducted by the ECB, this stifling of debate points at the anti-democratic tendency to disregard questions of legiti-

76 Infratest dimap, "ARD-DeutschlandTREND: Mai 2010," Infratest dimap, 2010, [http://www.infratest dimap.de/uploads/tx_nosimplegallery/ARD_DeutschlandTREND_Mai_2010_01.png](http://www.infratest-dimap.de/uploads/tx_nosimplegallery/ARD_DeutschlandTREND_Mai_2010_01.png).

77 Infratest dimap, "ARD-DeutschlandTREND: Juni 2010," Infratest dimap, 2010, [http://www.infratest dimap.de/uploads/tx_nosimplegallery/ARD_DeutschlandTREND_Juni_2010_04.PNG](http://www.infratest-dimap.de/uploads/tx_nosimplegallery/ARD_DeutschlandTREND_Juni_2010_04.PNG).

78 Infratest dimap, "ARD DeutschlandTREND: September 2011 Erweiterung des Rettungsschirms," Infratest dimap, 2011, [http://www.infratest dimap.de/uploads/tx_nosimplegallery/ARD_DeutschlandTREND_September2011_19.PNG](http://www.infratest-dimap.de/uploads/tx_nosimplegallery/ARD_DeutschlandTREND_September2011_19.PNG).

79 Infratest dimap, "ARD-DeutschlandTREND: September 2011 Zukünftig mehr oder weniger Europa," Infratest dimap, 2011, [http://www.infratest dimap.de/uploads/tx_nosimplegallery/ARD-DeutschlandTREND_September2011_18.PNG](http://www.infratest-dimap.de/uploads/tx_nosimplegallery/ARD-DeutschlandTREND_September2011_18.PNG).

80 Ekathimerini, "More than 40 MPs ousted as Greece approves EU-IMF deal," Ekathimerini.com, 2012, <http://www.ekathimerini.com/139090/article/ekathimerini/news/more-than-40-mps-ousted-as-greece-approves-eu-imf-deal>

81 public issue, "Οι κοινωνικές αντιδράσεις για τα νέα οικονομικά μέτρα," publicissue.gr, 2010, <http://www.publicissue.gr/wp-content/uploads/2010/05/dnt-may-20101.pdf>, 4.

82 public issue, "Πολιτικό Βαρόμετρο 92 Ιούλιος 2011," publicissue.gr, 2011, <http://www.publicissue.gr/wp-content/uploads/2011/07/varometro-07-2011.pdf>, 2.

mization when it concerns questions of European integration.

The genesis of the EMU substantiates this claim. When France and Germany presented their plan for introducing the European Currency Unit, which was absorbed by the euro, at the 1978 European Council meeting in Brussels, they did not plan for any debate. According to the French President at the time, Valéry Giscard d'Estaing, himself and Helmut Schmidt made an extensive presentation because if they had put the EMS “up for discussion first, everyone [would have given] their conceptions and opinions and distort[ed] the system.”⁸³

3.2. EUROPEAN INTERVENTIONS

In addition to the stifling of debates, the democratic process has been further hindered by the intervention of European institutions on a national level.

Within the context of the Irish debt crisis, the Irish financial sector’s reliance on central bank liquidity had increased to more than 150 billion euro at its peak, about 60 billion of which were provided through Emergency Liquidity Assistance (ELA) by the Irish NCB (see figure 7). ELA represents short-term liquidity assistance provided against collateral that misses the requirements of regular Eurosystem financing. It is extended by NCBs, however, the ECB has the right to prohibit any extension.

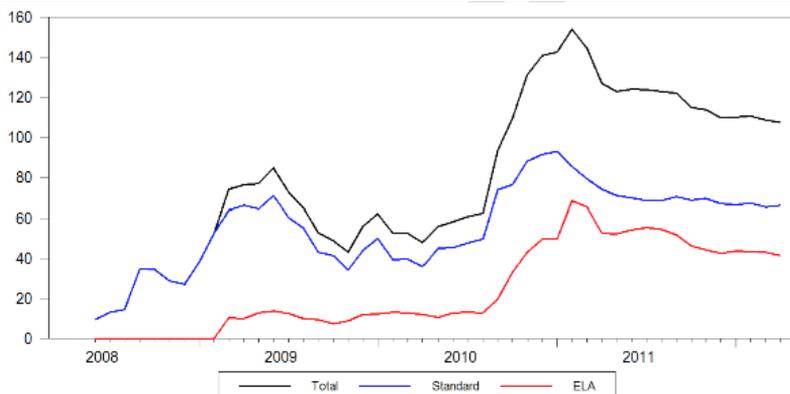


Figure 7: Eurosystem Borrowings by Guaranteed Irish Banks.

Source: Whelan, Karl. “The ECB’s Role in Financial Assistance Programmes.” European Parliament. 2012. <http://www.europarl.europa.eu/document/activities/cont/201207/20120705ATT48408/20120705ATT48408EN.pdf>.

Most of the information available today indicates that the ECB used this power over the Irish banking industry to force

83 Meurice, Jean-Michel, Jean Quatremer, 4:10.

Ireland into accepting a bailout program. In a report commissioned by the European Parliament, Whelan assumes “that the ECB [threatened to] withdraw liquidity support for Irish banks unless the government agreed to an EU-IMF program that would include a significant recapitalization of the banking sector.” However, he explicitly calls this only his “interpretation”.⁸⁴ Due to the ECB’s refusal to publish letters it exchanged with the Irish government at the time, this allegation remains neither proven nor refuted.

However, it has been proven that the ECB utilized its power to force the Irish government to refrain from bailing in private investors. According to a report on the Irish banking crisis commissioned by the Irish parliament, the Irish government wanted to bail-in unguaranteed⁸⁵ “unsecured senior bonds” and was encouraged to do so by the IMF.⁸⁶ However, these bail-ins never occurred. As Brian Hayes, deputy Minister of Finance in Ireland explains, the decision to drop this intention “was foisted on the Irish people” by the ECB.⁸⁷ Jörg Asmussen (a German member of the ECB’s executive board), when confronted with this charge, said nothing to rebut it. Instead, he explained the ECB “clearly saw the danger of contagion”, “that it was at that time the primary objective to prevent contagion”, and that he believes “the ECB has acted within its mandate.”⁸⁸

If the demand to drop any bail-in plans were included in the Irish program details, the ECB would have had a legal basis to make its demand. However, as Whelan reports: “The program makes no reference to the requirement that private unguaranteed bondholders be repaid. Indeed, such a clause would be unprecedented in an IMF program document.”⁸⁹ Therefore, the ECB was not acting within its mandate. In conclusion, a European institution dictated bailout policies to an elected European government without any legal grounds.

In Greece, a similar intervention by a European body occurred. As established in chapter 3.1., in July 2011 more than

84 Whelan, Karl, “The ECB’s Role in Financial Assistance Programmes,” European Parliament, 2012, <http://www.europarl.europa.eu/document/activities/cont/201207/20120705ATT48408/20120705ATT48408EN.pdf>, 6.

85 In the beginning of the crisis, the Irish government had guaranteed for the obligations of all of its major banks. However, those guarantees were temporary, and by the time of the Irish program, many had run out.

86 Joint Committee of Inquiry into the Banking Crisis, “REPORT,” Houses of the Oireachtas, 2013, <http://inquiries.oireachtas.ie/banking/wp-content/uploads/2016/01/02106-HOI-BE-Report-Volume1.pdf>, 360.

87 Bondy, Árpád; Schumann, Harald. “The Secret Bank Bailout.” Strasbourg: Association relative à la télévision européenne, 2013, 19:00.

88 Ibid, 17:50.

89 Whelan, Karl, 12.

80% of Greeks were thinking their country was moving in the wrong direction. In late November 2011, representatives from Greece and the EMU agreed on the details of a second economic adjustment program.⁹⁰ Two days later, protesters halted the annual national day parade. This was the first cancellation of the parade in its history. In addition, the protesters declared that all government representatives were traitors.⁹¹

Apparently, this overwhelming dissent prompted the Greek prime minister at the time, Giorgos Papandreou, to call a referendum over whether Greeks wanted to accept the second program or not. This referendum would have been the first in the country since the abolishment of the monarchy.⁹²

However, one week later, Papandreou had resigned, his deputy Evangelos Venizelos and the former leader of the Greek opposition Antonis Samaras had built a government of alleged national unity, and the referendum was never mentioned again. According to the *Financial Times*,⁹³ the reason for this sudden shift in Greek domestic policy was that the then-president of the European Commission, José Manuel Barroso, had conspired with Samaras and Venizelos in order to, as he is quoted, “kill this referendum.”

In other words, the president of the European Commission had schemed with Greek politicians to remove an elected premier from office, for the reason that he had wanted to let his people decide on his government’s stance towards Europe. Indeed, a Greek EMU exit at this point would have produced grave consequences in the rest of the EMU, given that neither the Banking Union nor the yield-reducing OMT were in place yet. However, the right to democratic self-determination of EU member states should not be contingent on the current state of the EMU.

These incidents, too, find their parallel in the genesis of the EMU. After the fall of the Berlin Wall, François Mitterrand, the French president at the time, threatened to utilize France’s status as one of the four powers that Germany had surrendered to in the Second World War to veto German reunification if Germa-

90 Euro Summit, “EURO SUMMIT STATEMENT,” European Council, 2011, http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/125644.pdf.

91 Flynn, Daniel, George Georgiopoulos, “Greek protesters call president “traitor,” halt parade,” Reuters.com, 2011, <http://www.reuters.com/article/us-greece-protest-idUSTRE79R27O20111028>.

92 Kyriakidou, Dina, Harry Papachristou, “Greek PM calls referendum on new EU aid deal,” Reuters.com, 2011, <http://www.reuters.com/article/us-greece-referendum-idUSTRE79U5PQ20111031>.

93 *Financial Times*, “How the Euro Was Saved,” FT.com, 2014, <https://next.ft.com/content/f6f4d6b4-ca2e-11e3-ac05-00144feabdco>, 9.

ny would not give up its hesitant position towards monetary union.⁹⁴ Accordingly, Joachim Bitterlich (at the time an advisor to the German chancellor) describes the following meeting of the European Council in Strasbourg, presided over by France, as a “shock” due to the sudden demise of Community support for German reunification.⁹⁵

In summary, the practice of diplomatic blackmail, and the deprivation of the European peoples’ right to self-determination that goes along with it has been an important tool to facilitate both the euro’s introduction and preservation.

4. CONCLUSION

While Europe has proven it is capable of keeping the EMU together, its efforts at solving the euro crisis’ causes were only successful as far as the private debt side is concerned– the doom loop was successfully eliminated, and a European framework of supervision was introduced. As far as the public debt side of the crisis is concerned, the European measures have not rectified the causes as the European governments still breach the regulations the EMU is supposed to be governed by.

Lacking the capability to remedy this particular cause of the crisis, Europe has set up a framework of bailouts and monetary financing which has been keeping the EMU alive. This framework does so at the tremendous costs of further eroding the relevance of the EMU regulations, whose spirit it breaches, and of redistributing wealth from households, banks, and insurance to the European governments, effectively promoting governmental capital squandering.

Together with the incapability to create an EMU regulatory regime that is actually obeyed, these societal costs can be attributed to the fact that the EMU was not built upon consensus. Rather, it was built upon the history of avoiding, instead of embracing, debate, and employing diplomatic pressure to further European integration. During the euro crisis, this history was repeated, as European institutions rid Greece and Ireland of

⁹⁴ Sauga, Michael, Stefan Simons, Klaus Wiegrefe. “The Price of Unity, Was the Deutsche Mark Sacrificed for Reunification?” Spiegel Online. 2010, <http://www.spiegel.de/international/germany/the-price-of-unity-was-the-deutsche-mark-sacrificed-for-reunification-a-719940.html>. Sauga, Siemons and Wiegrefe quote minutes from a meeting between Mitterrand and Hans-Dietrich Genscher, the German Minister of Foreign Affairs at the time, in which Mitterrand states: “Germany can only hope for reunification if it is part of a strong community, [...you] don’t have to be a psychologist to recognize that Germany is currently dragging its heels on economic and monetary union[.]”

⁹⁵ Meurice, Jean-Michel, Jean Quatremer, 13:30.

their right to self-determination, while European governments ostracized divergence of opinion in their parliaments.

Accordingly, the image of the EU among its citizens has constantly deteriorated over the past decade (see figure 8). Nationalist movements have grown to significant sizes in the entire European Union, and the European heads of state and government have been treating each other as everything but partners during the refugee crisis.

Q46b: I would like to ask you a question about how much trust you have in certain media and institutions. For each of the following media and institutions, please tell me if you tend to trust it or tend not to trust it.
(% - 10 = TEND TO TRUST)



Figure 8: Trust in the European Union.

Source: Eurobarometer, “Standard Eurobarometer 84 Autumn 2015,” Eurobarometer, 2015, <http://ec.europa.eu/COMMFrontOffice/PublicOpinion/index.cfm/ResultDoc/download/DocumentKy/70150>, p.8.

There is reason to believe that none of these problems will be solved until the policy of avoiding instead of embracing debate regarding the question of European integration is abolished. Accepting that the goal of irreversible European integration must not function as a diktat would be the first step on this path. With the British EU exit imminent, it is long overdue.

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Economy and Innovation

3. 1. The European Financial and Monetary Malaise: A Heterodox Analysis of the new Financial Regulations, the Banking Union, the Euro system, QE and its Consequences

SUBMITTED BY

Bernat Aritz Monge Nunes

ABSTRACT

“Are the regulatory changes implemented in the EU’s financial system effective to avert a new economic crisis in Europe?”. This was the simple yet enticing research question I had set out for one of my most recent academic works. This paper is a synthesized and specially adapted version of the much more detailed and comprehensive aforementioned work. With the purpose to confirm or deny this question I examined the Too Big To Fail problem, the Shadow Banking, the Banking Union, the Basel III framework, and the problems of the Euro and the palliative monetary policy of the ECB. I concluded with considerations about how bubbles and crises in the economy (be them financial or of another kind) are recurrent themes, about deregulation, and how in order to avoid the repetition of old errors 3 main solutions should have to be implemented. First: the reform of the universal banking model along the impulse of the good aspects of the Banking Union and Basel III. Second: the fragmentation of the Euro system to avoid the pervasive incentives and misalignments of the Euro. Third: the public control of new rule-based Central Banks for adequate QE.

1. THE STATE OF THE BANKING INDUSTRY

One of the undeniable effects of the gargantuan growth and development of the financial markets in Europe and worldwide and that the Financial Crisis has shown to us in all its crudeness is that the financial markets have outgrown the adequacy of individual States to cope with the problems of their financial sectors.

In Europe the Financial Crisis has been even more prominent, holding the biggest and most enduring crisis in relative terms in the world. This is not strange, in fact one could very well argue that it is an ingrained consequence in the process of European integration.

The progressive free circulation of capital and services within the Union along with a common currency for the majority of its members (which creates and endures its own problems due to the fact that Europe is not an optimal currency area) makes it possible for big financial corporations to expand and grow even easier and faster inside the EU, making big banks and financial firms too unmanageable for individual States in case of big and abrupt losses and depreciation of their assets, which put a very high systemic risk on their economies.

Therefore, the European institutions and the Member States have to step in and design new common regulations and mechanisms to overcome the problems that the previous “wave” of integration had laid down the ground for. To elaborate more on this idea: the current Banking Union and the gradual fiscal integration are an intrinsic part of the more comprehensive process of European integration.

They reassert the idea of the European integration movement as being a reinforcing one, where one wave of integration puts the seeds for a future crisis and a subsequent expansion of the integration (although not without collateral costs and certainly not without peaks of tension among countries and European citizens). It has also been an “integration from above” and towards political and legal centralization, guided and chiselled by the Member States, big corporate conglomerates and the executive branch (namely the Commission) of the EEC and the EU.

So, in order to assess the adequacy of the Banking Union and the new European legislative acts to the economic circumstances we have to inescapably analyse the most important issues of the state of the financial sector, namely the industrial organisation of the banking industry.

Instead of offering a complete and exhaustive radiology of the financial markets I want to concentrate in explaining what I consider the key points of the financial industry in Europe: The Too-big-to-fail problem and its approaches, and the Shadow Banking. Then we will start with the proper analysis of the Banking Union and the Basel III regulatory framework.

1.1. TOO-BIG-TO-FAIL

On an aggregate EU perspective we can see that between 2005 and 2013 the concentration of the EU banking sector had been increasing to roughly 700 points on the Herfindahl Index in 2013, with the top 5 banks controlling 46% of the total assets of the industry, a tendency that has been counterbalanced by the toughest dips of the recession in 2008-2009 and in 2011-2012.

So on average we could say that the EU's banking sector has a quite notable degree of concentration; that of an oligopoly and it is arguable that it will continue to increase in the near future.¹

The European Banking Union has put in place single supervisory and resolution mechanisms for banks, but the regulations and the public debate over the European Banking Union have left quite unattended the question of whether overall the financial sector in Europe should be more or less concentrated.

The legislative acts and the mechanisms of the Banking Union do not address the structural fundamentals of the problem of the “too-big-too-fail” banks, they quite simply just try to accommodate the European Union institutional setting to an economic situation where the banking sector is very interconnected in Europe and eight years after the crisis it is even more concentrated. This is partly due to the policies promoted by the EU Commission itself to try improve the resilience of national financial systems through bank concentration.

Too-big-to-fail entities can take the form of Depository institutions (which include banks, trust companies, mortgage loan companies, etc.), Contractual institutions (pension funds, insurance companies, etc.) and Investment institutions (mainly investment banks, brokerage firms and underwriters).

The model in force of “Universal banks” in the European Union, Japan and also in the United States even before the

¹ Pawlowska, Malgorzata. NBP Working Paper 205. (Warsaw: Narodowy Bank Polski. Economic Institute, 2015).

Gramm-Leach-Bliley Act of 1999 - which in principle does not limit the combination of financial activities that a financial institution can undertake (be it activities of depositary, investment or contractual firms) - has led to the consolidation of very big and systemically important banks that share these characteristics. That is the reason why the term too-big-to-fail is particularly used to refer to these mega-banks.

There is quite a strong consensus between economists² that the TBTF and the universal banking system where at the very least a main cause of the long and deep extent to which the financial problems and its mismanagement went. The main problems identified with the TBTFs are not specially new in financial economics, and they are:

1. The fall of a systemically important bank (or a shadow bank) implies the loss of deposits (beyond the 100.000€ guarantee for conventional banks), the inability to continue credit operations, a sudden fall of economic activity, large numbers of lay-offs in the economy, revenue losses for national governments and increase in public spending (due to the action of automatic stabilizing fiscal mechanisms) and as a consequence of this chain of events, even bigger falls in economic activity.

If not addressed by a sufficiently resourceful, centralized (or well-coordinated) agent like a Central Bank or a national government, these effects create a spiralling effect, as other financial institutions rely on the transactions that they have with that systemically important firm, and also on the transactions that their clients have with this TBTF and the second financial firm.

Hence, there is a financial contagion of the effects of this TBTF fall, which can in turn generate panic and further amplify its consequences, turning into a self-fulfilled prophecy and an even bigger loss of social welfare.

2. Due to the importance of financial markets - which have an asymmetrical role in current economic systems compared to other branches of economic activity - TBTFs are prone to very severe moral hazard issues, knowing they are systemically very important agents. They can drag their feet on the adoption of regulation, its super-

² Goldstein, Morris and Véron, Nicolas. Too Big To Fail: The Transatlantic Debate. (Brussels: Bruegel, 2011). Page 4.

vision is intricate and proper enforcement of regulations is of utmost importance.

A notable example is the “living wills” of banks, plans which banks themselves have to design dealing with their winding down in case of a failure, some of the biggest financial institutions are not in a position

3. The TBTFs tend to distort competition borrowing at lower interest rates than all other institutions taking advantage of the expectations from the economic agents that they are guaranteed by national governments, and they also take higher risks.³ If not adequately regulated and supervised, they have incentives to counterbalance the associate cost- savings generated with financial economies of scale with increasing systemic risk. Overhead expenses can also counterbalance the benefits of financial economies of scale, for TBTFs⁴

That ought to make us not forget about the potential benefits of large banks. They do have economies of scale advantages respect to other medium and small size competitors.⁵

The fundamental problem lies in that although very large banks can present economies of scale, a concoction of factors – including the own diseconomies of overhead expenses of TBTFs - render them more troubling than worthwhile.

Their moral hazard, the universal banking system, the problems that very rapid innovation in financial markets and products entail (in terms of transparency and risk-assessment), the presence and the estimated size of shadow banking, and a decrease of capital and financial controls render conventional regulation of financial firms and the accommodation of institutions to increasingly big TBTF - like the Dodd- Frank Act in the USA or the Banking Union in the EU or the Basel III framework at an international level – wholly inadequate. They do not address the main structural problems of the enormous development and complexity that financial markets have experimented and which caused the financial crisis and will likely show up again in a new one.

3 IMF Survey. (2014). Global Financial Stability Report 2014. (Washington DC: International Monetary Fund, 2014). Pages 101-130.

4 Winters, Harvard. Where Are the Economies of Scale We Were Promised?. (New York: American Banker, 2013).

5 Anderson, Ronald W. and Joeveer, Karin. Bankers and bank investors: Reconsidering the economies of scale in banking (London: LSE, 2012).

The two best solutions proposed to the problems of the TBTFs that I have come across are:

1. Generate bigger institutional mechanisms at the international and/or national level to cope with bigger universal financial entities. This is actually the main course that the European Union and the USA have followed since the break out of the crisis and that I treat the most in this dissertation.

The aim of this solution is to reduce the likeness of megabanks' distress through higher capital requirements, a more adequate way of measuring risk of financial products, the establishment of bail-in mechanisms and a more centralized system of supervision and resolution of troubled financial entities.

In the case of the Banking Union this last characteristic would also be aimed at reducing the exploitation of loopholes by financial institutions in their inter-European activities previously subjected to a much decentralized form of banking supervision and regulation. Some countries have also been in favour of the implementation of harmonised financial transaction taxes.⁶

2. Reform the model of universal banking. A relatively simple and quick way of dealing with the Too-Big-To-Fail problem would be to establish by law that financial entities would have to choose between being conventional depository institutions and operate within the confines of more conventional banking or being investment or contractual institutions, or implement a similar kind of differentiation that could be more suitable. The so-called "21st Century Glass-Steagal Act"^{7,8} is one of the main propositions in this field.

The aim here would be to reduce the risk-taking opportunities of big depository institutions which generate the biggest systemic issues and moral hazard. The most novel and risky practices and products in financial markets would be carried out by more specialized banks.

A measure of this sort would reduce the systemic and

6 Hemmelgarn, Thomas; Nicodème, Gaëtan; Tasnadi, Bogdan and Vermote, Pol. Financial Transaction Taxes in the European Union. (Brussels, European Commission, 2015).

7 Waddell, Melanie. Sen. Warren Reintroduces Bill to Restore Glass-Steagal. (Hoboken, New Jersey: ThinkAdvisor, 2015).

8 Baker, Dean. Glass-Steagal Now: Because the Banks Own Washington. (Washington DC: CEPR, 2013).

distortionary problems of TBTFs, implying a relative reduction of their size based on their financial activities, not on artificial caps on total assets of universal banks, and would also reduce the contagion problems of risky, badly assessed financial activities to the whole financial system.

As a result, the positive aspects of institutional and regulatory responses like the Banking Union, and Basel III could be more effective. Non-systemic financial entities that were to undertake more risky financial activities would not be offered public bail-outs. Bail-in mechanisms of financial institutions (both systemic depository institutions and other non-systemic financial firms) would be more manageable. It would demand less urgent public intervention and would require a much more limited use of public funds if a bail-in mechanism were to prove to be insufficient in case of systemically important depository institutions, due to its lesser size.

I am in favour of a proposition with this aspects since it integrates the positive but insufficient improvements of the Banking Union and Basel III with a sound and deeper structural response to the financial crisis and its ensuing malaise, which would prevent the repetition of old errors.

The only drawback would be that structural measures to limit the scope of banks could entail some reduction of economies of scope. But the benefits of lesser financial distortion, easier and more efficient supervision, regulation, risk-management and firm management, lesser moral risk problems, higher stability and lesser economic and social costs during downturns and “black swans” would arguably greatly exceed this drawback.

2. SHADOW BANKING AND WHY WE DO NOT SEE CRISES COMING

The 2008-2009 crisis detonator was, overall, a sudden disruption in shadow banking activities. More specifically, the detonators included a combination of a run on short term bank debt, a sudden lack of liquidity in the commercial paper money market (which comprises unsecured corporate short-term debt with usually very short-term cash-in possibilities and very short maturities; a maximum of 9 months) and a fall of confidence between banks, due to the unknown real risk and amount of non-performing Collateralized Debt Obligations (CDO) using as collaterals real estate assets and Credit Default Swap (CDS)

derivatives.

Institutions labelled as Shadow banks engage in maturity transformation, meaning they borrow money from investors (which can mostly withdraw at any time) at short-term and fund the purchase of assets with a longer time span, like commercial banks. A crucial difference of Shadow Banks is that precisely because they are not regulated as traditional banks, they cannot borrow from the Central banks (which act as lenders of last resort) in case of a run, and because they have no conventional depositors, their investors have no guarantee scheme on their funds, and the capital requirements are more lax. This makes shadow banks a lot more prone to runs and financial hysteria.

These markets are still very much out of the scope of the Central Banks and the regulatory agencies and very insufficient steps have been slowly taken in this respect. One fundamental problem is that data about Shadow Banking is still far from comprehensive, and economists still struggle to cope and understand the vast reach and implications of shadow banking and unconventional financial activities. The lack of knowledge makes it even harder to regulate adequately these institutions and activities so that they do not pose systemic problems in the economy.

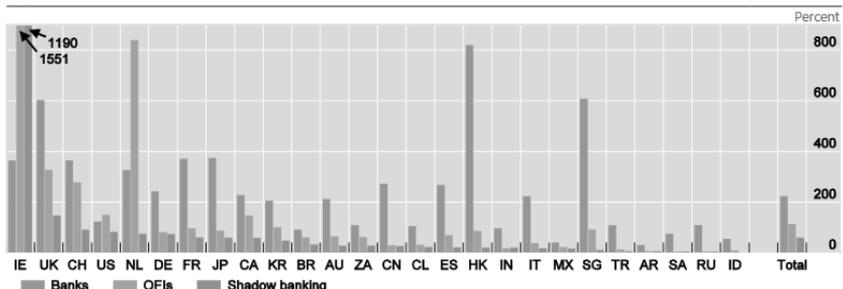
The most recent FSB Monitoring Report of 2015 is to this date the most comprehensive data of the worldwide magnitude of the Shadow Banking industry.

From the following graphs we can gain a better understanding of the approximate size of shadow banking.

Shadow banking, OFIs and banks as a percent of GDP

26 jurisdictions at end-2014

Exhibit 6



Note: Banks = broader category of 'deposit-taking institutions'; OFIs = Other Financial Intermediaries; Shadow Banking = economic function-based measure of shadow banking. AR = Argentina; AU = Australia; BR = Brazil; CA = Canada; CH = Switzerland; CN = China; CL = Chile; DE = Germany; ES = Spain; FR = France; HK = Hong Kong; IE = Ireland; ID = Indonesia; IN = India; IT = Italy; JP = Japan; KR = Korea; MX = Mexico; NL = Netherlands; RU = Russia; SA = Saudi Arabia; SG = Singapore; TR = Turkey; UK = United Kingdom; US = United States; ZA = South Africa.

Figure 1: Shadow banking as percent of GDP

Source: Financial Stability Board. *Global Shadow Banking Monitoring Report 2015*. Page 11-12.

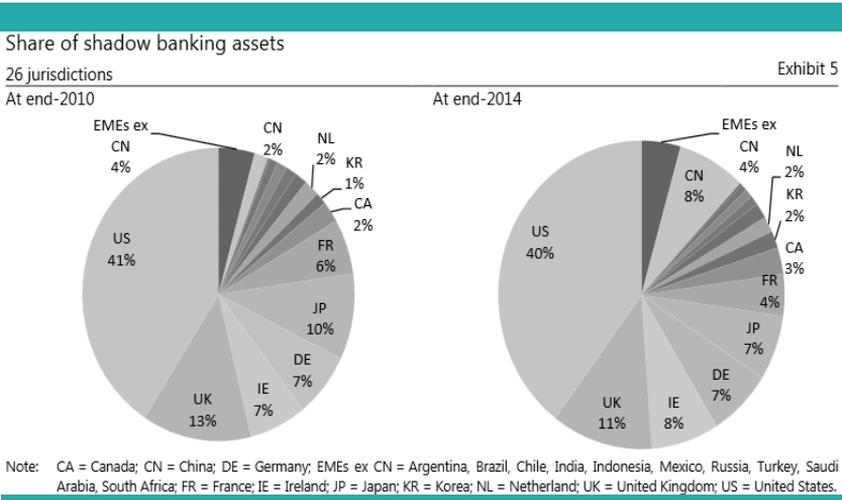


Figure 2: Share of shadow banking assets
Source: Financial Stability Board. Global Shadow Banking Monitoring Report 2015. Page 11-12.

Classification by Economic Functions
Exhibit 1

Economic Function	Definition	Typical entity types ²¹
EF1	Management of collective investment vehicles with features that make them susceptible to runs	Fixed income funds, mixed funds, credit hedge funds, real estate funds
EF2	Loan provision that is dependent on short-term funding	Finance companies, leasing companies, factoring companies, consumer credit companies
EF3	Intermediation of market activities that is dependent on short-term funding or on secured funding of client assets	Broker-dealers
EF4	Facilitation of credit creation	Credit insurance companies, financial guarantors, monolines
EF5	Securitisation-based credit intermediation and funding of financial entities	Securitisation vehicles

Figure 3: Classification by economic Functions.
Source: Financial Stability Board. Global Shadow Banking Monitoring Report 2015.

The “Narrow definition” of shadow banking accounted for 36 trillion dollars in assets in 2014. An amount representing 59% of the analysed countries’ GDP and 12% of total financial assets. It is stated that:

“The new classification by economic functions shows that credit

intermediation associated with collective investment vehicles with features that make them susceptible to runs (e.g. money market funds (MMFs), hedge funds and other investment funds) represents 60% of the narrow measure of shadow banking. It has grown more than 10% on average over the past four years. By contrast, the level of securitisation -based credit intermediation – among the key contributors to the financial crisis – has fallen in recent years.

At the aggregate level, interconnectedness between the banking and the non-bank financial system, excluding those OFIs that are prudentially consolidated into banking groups, continues to decrease from its pre-crisis peak. However, in some jurisdictions, OFIs' credit and funding exposures to banking systems are reported to be quite high and merit further assessment as to the extent of concentration of exposures and underlying risks.

The measurement of shadow banking risks – including leverage, liquidity and maturity transformation, and imperfect credit risk transfer – continues to face challenges in data availability.” - FSB 2015 Monitoring Report (2015). Page 2.

2.1. INTERCONNECTEDNESS

A crucial aspect of shadow banking is that it is very interconnected with formal banking firms. According to the FSB 2013 Monitoring Report⁹ these connections can be direct, if non-banking firms form part of the bank intermediation chain or benefit implicitly or explicitly from banking entities' support. It can also take the form of interdependence on the holding of each other's assets (mainly through debt securities) between shadow banks and banks.

Indirect interconnectedness exists when a bank and a shadow bank make investments in related assets or activities, or are exposed to a significant number of common counterparties.

This interconnectedness exacerbates when banks want to pursue higher yielding activities to increase their margins and therefore channel investments through shadow banking, which are subject to much more lax regulations and take on much riskier activities.

The inadequacy of information and opacity in these financial markets' products, services and practices (securitizations, complex forms of swaps, debt bundling, etc.) coupled with the interconnectedness with the formal banking system make it very difficult to accurately measure real asset value, predict liquid-

⁹ Financial Stability Board. Global Shadow Banking Monitoring Report 2013. (Basel: FSB, 2013). Pages 8-19.

ity issues and runs in the shadow financial system, the money market that then transmit to the regular banking system. To the point that- as I have previously discussed - the newly created FSB (and the national and transnational organisations that depend on it) have difficulties in even estimating the size of shadow banking and the scope of its activities.

3. THE STRUCTURAL REASONS AND PROBLEMS THAT GENERATED THE FINANCIAL CRISIS

Hence, financial markets have turned to be even more potentially unstable and prone to panics and we have seen since the end of the eighties a change in nature of financial crises.¹⁰ Trust in this setting has become in a sense the economic and market stabilising substitute for information, that's why in economic policy thinking and in financial debate it has become such a prominent matter.¹¹

Another implication of this tendency is that Fair-value accounting (estimating prices on the potential market value) becomes a mechanism by which – when confidence evaporates after mounting unperceived structural financial problems – panics are even more acute, since there is no need for some similar types or number of securities to default to change the values, simply changes in the perception that they will soon default. This increases the contagion to other products and securities in order to gain liquidity quickly and de-leverage, and transforms the panic in even greater losses in the asset valuation.

That's another reason capital requirements are vulnerable from both the side of assets and the side of liabilities. A company may appear to have more than enough capital requirements, but a large period of confidence and trust without appropriate nor enough information can very likely transform into a huge mispricing and misassessment of financial assets and products, and the panic (also a reinforcing downward spiral of asset pricing) makes depositors and bondholders to withdraw and sell their bonds, increasing the pressure from the liabilities side.

The progressive weakening of the Glass-Steagall Act during the 1980s and its final substitution by the Gramm-Leach-Bliley Act in 1999 (as part of the phenomena of a “social bubble”) not only decisively contributed to the problems of the Too-Big-To-Fails, it also had the indirect effect of stimulating shadow

¹⁰ The Economist. *The Slumps that shaped modern finance*. (London: The Economist, 2014).

¹¹ Tonkiss, Fran. *Trust, Confidence and Economic Crisis*. (Brussels: CEPS, 2009).

banking to new heights. In other words, it had a very substantial and negative effects on the structure of the financial system as a whole.

Economist Yves Smith offers a very insightful explanation of the dismantling of Glass- Steagall and its consequences for the banking sector and the shadow financial sector¹² that I encourage to fully read.

A credit bubble of real estate loans was important, but was even more significant in the total reverberating effects of the credit bubble burst (and what truly made a worldwide financial crisis) was the use and spread of financial derivative products, specially Collateralized Debt Obligations and Credit Default Swaps.

“The synthetic exposures were somewhere between 4 and 6 times the value of real economy subprime risk. And a high percent of the CDS exposures (whose risk was masked by packing them into collateralized debt obligations, see ECONNED for a long- form discussion) wound up at under-capitalized, systemically important financial firms.” - Yves Smith (2016).¹³

On the structural effects of the dismantling of Glass-Steagall through the 80s and 90s:

“Over the next few years, Glass Steagall was shot full of holes. Banking regulators accepted the premise that McKinsey was pushing at the time: traditional banks were facing a profit squeeze, hence they needed to be allowed to pursue higher margin activities like investment banking. The other excuse was that US banks were at a disadvantage relative to Eurobanks, which were universal banks.

[...] So by the late 1990s, [...] the various big capital markets firms, which meant Eurobanks like Deutsche, Credit Suisse, and UBS, big US commercial banks like Citigroup, and the old investment banks were all competing in many of each other's markets. More important all were pursuing the same general strategy: originate, trade and sell the full suite of capital markets instruments (debt, equity, FX, and related derivatives) and related pure advisory services in all the major financial centers in the world. Pretty much all firms were also pursuing asset management too, even though that was not quite as integral.

Now what was the big danger here?

This approach had huge fixed costs: a really big international IT operation and back office, including all those trader stations and data

¹² Smith, Yves. Why Larry Summers is Wrong and Bernie Sanders is Right on Glass-Steagall. (New York: Naked Keynesianism, 2016).

¹³ Ibid

feeds (which were constantly updated, since better risk management tools and trader decision support were one axis of competition), office space in the best part of town in financial centers all over the world, and most important, all those highly-paid and high-maintenance professionals, as in “talent”. Even though management tried to lower how much was fixed costs via performance bonuses, this was often undermined by the practice of poaching senior individuals and even full teams with hefty 2-3 year pay guarantees (pervasive at also-rans seeking to catch up with the leaders).

So what this meant in practice was that a top firm, say a Goldman, would have 100% of a certain cost level. We’ll index their revenues as 100. Its close competitors might have pretty much the same costs but only 90% of the revenues. The next tier players would have only 70-90% of the costs but 50-60% of the revenues.

It was perceived to be imperative to get to at least a perceived-to-be-competitive footprint, which for practical purposes would entail something like 85% of the costs of the capital markets leaders. But there was great leverage on that cost base. So getting to the minimum level of geographic and product coverage was merely the very big cost of entry in the capital markets game.

[...] We pointed out the danger of being a subscale player. You were already under pressure to increase your infrastructure (products depth and range, as well as geographic footprint) when you didn’t have the revenue of the top players. If you were subscale and had any pockets of strength, you were in constant danger of having those teams raided by firms that had a bigger platform. Odds were high they’d do no worse and would probably be more productive if they jumped ship. And once you had teams being picked off, you were on your way to losing your independence. The businesses were tightly integrated enough that losing a team would damage your standing in related businesses, making those professionals less productive (as in lowering their bonus prospects) and increasing the odds they’d leave or be recruited away.

It was thus imperative for a subscale player to work like mad to climb his way up the food chain. He had to have any realistic chance of long-term survival.

Since these firms couldn’t match the raw revenue generation power of their bigger peers, they had to focus their resources on higher potential profit businesses. They’d wind up making bigger bets on what they thought were the best opportunities. And since the profit model in the late 1990s and early 2000s, thanks to falling and ultimately negative real interest rates, shifted the business model away from lower-risk fee businesses to higher risk trading businesses, it also entailed taking more balance sheet risk.

Who were the most subscale players? Bear Stearns and Lehman. And what was their big strategic bet? Real estate, particularly the seemingly high profit subprime sector. And for Bear, that also meant becoming a big player in credit default swaps (recall that Bear was one of the few players that John Paulson approached early on to create CDOs that were designed to fail).

Smith goes on in explaining the strategies and developments of other financial firms such as AIG, an insurance mega-company (which would classify as an OFI according to the FSB) which failed and was bailed out due to its insurance exposure to the derivatives we have discussed; and Fannie Mae and Freddie Mac. But the main idea is to see how a progressive dismantlement of the Glass-Steagall Act generated structural incentives for the proliferation of the banking system, and how banks and other financial shadow companies and insurance companies became deeply intertwined, increasing the systemic risk of failures.

3.1. EUROPE

In the specific case of the European Union the build up was somewhat different since universal banking system was already present, shadow banking simply expanded in similar lines and the European financial system developed exposure to the shadow financial products.¹⁴ And so, the initial shock of 2008-2009 greatly affected the banking sector and the economies of the EU, it was the first of the three types of crises of the Eurozone,¹⁵ but the structural problems and pervasive incentives of the Eurozone system aggravated the resolution of the crisis, and it has been since then followed by Sovereign Debt Crises and/or Growth Crises. Both in Europe and in the USA there is a problem of addressing shadow banking regulation which could well be one of the main contributing factors for a next financial crisis. And so, next crises are bound to have similar detonators in this respect, although the causes can be different.

4. THE EUROPEAN BANKING UNION

The Banking Union addresses a financial trilemma between financial stability, financial integration and preserving

¹⁴ European Commission. Why did the crisis happen?. (Brussels: EC, 2014).

¹⁵ Shambaugh, Jay C. The Euro's Three Crises. (Washington D.C.: Brookings Papers on Economic Activity, 2012). Chapter: The Banking Crisis.

supervision at the national level, by option for a consolidation of the first two. This strategy has materialised in the establishment of three main building blocks to increase the resilience and the long-term health and efficiency of the European financial system.

1. The Single Rulebook: the first building block of the Banking Union and developed by the European Banking Authority (EBA). It establishes a unified set of financial legislation which all of the more than 8000 financial institutions operating in the EU must abide by in order to facilitate a more suitable and coherent regulation of the financial system. It also lays out the legislation that the Single Supervisory Mechanism, the Single Resolution Mechanism and the European Deposit Insurance Scheme have to follow.

This set of legal acts treat a wide range of issues, which can be broadly classified in 3 main issues:

a. Capital requirements for banks.

Directive CRD IV and Regulation CRR on capital and prudential requirements. They are mostly the legal vehicles to adapt Basel III framework at the Eurozone level (and with the potential incorporation from other EU Member States), and in accordance with the timeline proposed by Basel III.

It shows some improvements over Basel III:¹⁶ Specially relevant improvements are a more extensive range of institutions, additional optional capital buffers, a cap on variable executive remuneration and improved transparency regarding the activities in different jurisdictions on taxes, profits, etc.

b. Harmonization of rules on Deposit Guarantee Schemes.

c. Dispositions for the recovery and resolution of banks. BRRD Directive.

2. Single Supervision: The Banking Union establishes the Single Supervisory Mechanism (SSM) by which the European Central Bank becomes the Eurozone's chief supervisor of financial institutions and of those EU Member States who

¹⁶ European Commission. Capital Requirements - CRD IV/CRR – Frequently Asked Questions. (Brussels: EC Press release database, 2015).

willingly decide to enter the SSM even though they do not use the Euro as their currency.

The objective of this mechanism is to improve the supervision of the compliance of Eurozone banks (more than 6,000 plus the potential additions) with the Single Rulebook.

In this system with a higher degree of centralization, the ECB supervises that the largest systemic banks comply with the Single Rulebook, while the National Central Banks keep supervising the more modest.

The ECB supervisory role is established as a separate branch from its monetary branch in order to avoid conflicts of interest.

3. Single Resolution: The newly created Single Resolution Mechanism (SRM) puts in place a unified system by which in the case of bank failures a Single Resolution Board (SRB) will manage more effectively and coherently bank resolutions, and will be equipped with a Single Resolution Fund (SRF) financed by the banking sector. It is the mechanism entrusted with the mission of enforcing the Bank Recovery and Resolution Directive (BRRD).

The aim is to improve the efficiency of failing banks resolution and reducing the cost of financial failures for citizens and national governments.

4.1. THE BAIL-IN POLICY AND THE SINGLE RESOLUTION FUND

The Single Resolution Mechanism has as its primary policy a Bail-in one, opposed to the Bail-out of financial entities with public funds by national governments.

The SRF has been set up recently, on January the first of 2016 and with a time horizon of 8 years until its mature form. It is a fund that will have to be funded through annual contributions of banks and investment firms' operating within the confines of the Banking Union and with a target of at least 1% of the sum of all the covered deposits¹⁷ reaching the sum of €55bn by 2024.

The use of these funds will be triggered only in case an 8% write-off on the affected bank's shareholders, creditors and

¹⁷ Council of the European Union. Single Resolution Fund: Council agrees on bank contributions. (Brussels: European Council Press department, 2014).

depositors is not sufficient.

A lot of critiques have focused on the SRF,¹⁸ due to the insufficient of funds, an intervention process to act when the damage is already done, its transition period and the potential drawbacks of bail-in, which could spur its own financial problems and panics.

European Deposit Insurance Scheme:

According to the Commission,¹⁹ and modelled on the extended system of national Deposit Guarantee Schemes (DGS), the EDIS seeks to reduce risk and improve risk-sharing guaranteeing in case of banks' failures a sum of 100.000 Euros to all deposits in the Banking Union through a common system.

5. BASEL III

The globalisation of financial and banking services makes Europe susceptible to be affected by foreign shocks and vice versa: foreign countries are affected by financial shocks originating in the EU and the Eurozone, which are major global financial markets, dominated by huge banking sectors. That's why it is important to understand what are the main problems that the majority of economies can suffer derived from the potential failures of Basel financial frameworks.

Basel II proved to be insufficient to adequately regulate the increasing growth, globalisation and leverage of the banking sector worldwide. As it is stated in the BIS web: *“Even before Lehman Brothers collapsed in September 2008, the need for a fundamental strengthening of the Basel II framework had become apparent. The banking sector had entered the financial crisis with too much leverage and inadequate liquidity buffers. These defects were accompanied by poor governance and risk management, as well as inappropriate incentive structures. The dangerous combination of these factors was demonstrated by the mispricing of credit and liquidity risk, and excess credit growth.”* - BIS. History of Basel Committee. Towards Basel III (2015).²⁰

Thereupon, during the financial crisis, the BIS first issued in July 2009 the document “Principles for sound liquidity risk management and supervision” which was followed by meetings of the Basel Committee and the final proposal of Basel III in

¹⁸ Parigi, M. Bruno. The Economics of Bank Resolution. (Zurich: Presentation for UFSP, 2014).

¹⁹ European Commission. (2015). A European Deposit Insurance Scheme (EDIS) – Frequently Asked Questions. (Brussels: EC Press release Database, 2015)

²⁰ Bank for International Settlements. History of the Basel Committee. (Basel: BIS, 2015).

December of 2010.

In summary, the main innovations of the new Basel III framework according to the BIS include:

		Capital							
		Pillar 1			Pillar 2	Pillar 3			
Capital		Risk coverage	Containing leverage	Risk management and supervision	Market discipline				
All Banks	<p>Quality and level of capital Greater focus on common equity. The minimum will be raised to 4.5% of risk-weighted assets, after deductions.</p> <p>Capital loss absorption at the point of non-viability Contractual terms of capital instruments will include a clause that allows – at the discretion of the relevant authority – write-off or conversion to common shares if the bank is judged to be non-viable. This principle increases the contribution of the private sector to resolving future banking crises and thereby reduces moral hazard.</p> <p>Capital conservation buffer Comprising common equity of 2.5% of risk-weighted assets, bringing the total common equity standard to 7%. Constraint on a bank's discretionary distributions will be imposed when banks fall into the buffer range.</p> <p>Countercyclical buffer Imposed within a range of 0-2.5% comprising common equity, when authorities judge credit growth is resulting in an unacceptable build up of systematic risk.</p>	<p>Securitisations Strengthens the capital treatment for certain complex securitisations. Requires banks to conduct more rigorous credit analyses of externally rated securitisation exposures.</p> <p>Trading book Significantly higher capital for trading and derivatives activities, as well as complex securitisations held in the trading book. Introduction of a stressed value-at-risk framework to help mitigate procyclicality. A capital charge for incremental risk that estimates the default and migration risks of unsecured credit products and takes liquidity into account.</p> <p>Counterparty credit risk Substantial strengthening of the counterparty credit risk framework. Includes: more stringent requirements for measuring exposure; capital incentives for banks to use central counterparties for derivatives; and higher capital for inter-financial sector exposures.</p> <p>Bank exposures to central counterparties (CCPs) The Committee has proposed that trade exposures to a qualifying CCP will receive a 2% risk weight and default fund exposures to a qualifying CCP will be capitalised according to a risk-based method that consistently and simply estimates risk arising from such default fund.</p>	<p>Leverage ratio A non-risk-based leverage ratio that includes off-balance sheet exposures will serve as a backstop to the risk-based capital requirement. Also helps contain system wide build up of leverage.</p>	<p>Supplemental Pillar 2 requirements. Address firm-wide governance and risk management: capturing the risk of off-balance sheet exposures and securitisation activities; managing risk concentrations; providing incentives for banks to better manage risk and returns over the long term; sound compensation practices; valuation practices; stress testing; accounting standards for financial instruments; corporate governance; and supervisory colleges.</p>	<p>Revised Pillar 3 disclosures requirements The requirements introduced relate to securitisation exposures and sponsorship of off-balance sheet vehicles. Enhanced disclosures on the detail of the components of regulatory capital and their reconciliation to the reported accounts will be required, including a comprehensive explanation of how a bank calculates its regulatory capital ratios.</p>				
Phases		2013	2014	2015	2016	2017	2018	2019	
Capital	Leverage Ratio		Parallel run 1 Jan 2013 – 1 Jan 2017 Disclosure starts 1 Jan 2015					Migration to Pillar 1	
	Minimum Common Equity Capital Ratio	3.5%	4.0%			4.5%		4.5%	
	Capital Conservation Buffer				0.625%	1.25%	1.875%	2.5%	
	Minimum common equity plus capital conservation buffer	3.5%	4.0%	4.5%	5.125%	5.75%	6.375%	7.0%	
	Phase-in of deductions from CET1*		20%	40%	60%	80%	100%	100%	
	Minimum Tier 1 Capital	4.5%	5.5%		6.0%			6.0%	
	Minimum Total Capital			8.0%				8.0%	
	Minimum Total Capital plus conservation buffer		8.0%		8.625%	9.25%	9.875%	10.5%	
Capital instruments that no longer qualify as non-core Tier 1 capital or Tier 2 capital			Phased out over 10 year horizon beginning 2013						
Liquidity	Liquidity coverage ratio – minimum requirement			60%	70%	80%	90%	100%	
	Net stable funding ratio						Introduce minimum standard		

* Including amounts exceeding the limit for deferred tax assets (DTAs), mortgage servicing rights (MSRs) and financials.

In addition to meeting the Basel III requirements, global systemically important financial institutions (SIFIs) must have higher loss absorbency capacity to reflect the greater risks that they pose to the financial system. The Committee has developed a methodology that includes both quantitative indicators and qualitative elements to identify global systemically important banks (SIBs). The additional loss absorbency requirements are to be met with a progressive Common Equity Tier 1 (CET1) capital requirement ranging from 1% to 2.5%, depending on a bank's systemic importance. For banks facing the highest SIB surcharge, an additional loss absorbency of 1% could be applied as a disincentive to increase materially their global systemic importance in the future. A consultative document was published in cooperation with the Financial Stability Board, which is coordinating the overall set of measures to reduce the moral hazard posed by global SIFIs.

Source: Bank for International Settlements. *International regulatory framework for banks. (Basel III)*

5.1. THE GOOD ADDITIONS OF BASEL III

Notably, the best additions of Basel III are the introduction of the concept of cyclical capital buffers. In other words, supervisory bodies ought to increase capital requirements when the economy and the financial system is overheating, counterbalancing the procyclicality that real estate and financial systems have on the economy.

Nonetheless, in the banking Union these capital buffers are optional and the Eurozone Member States' Central banks determine the countercyclical buffers, which greatly diminishes the potential for such measures.

Also, the containment of leverage is a good measure to avoid the amplification of failing assets or products or Non Performing Loans in the real economy. In this case a Leverage Ratio is the chosen tool. In the case of the Banking Union, the leverage ratio is expected to come into force in 2018.

It has been argued by the ECB that the introduction of a

Liquidity
<p>Global liquidity standard and supervisory monitoring</p>
<p>Liquidity coverage ratio The liquidity coverage ratio (LCR) will require banks to have sufficient high-quality liquid assets to withstand a 30-day stressed funding scenario that is specified by supervisors.</p>
<p>Net stable funding ratio The net stable funding ratio (NSFR) is a longer-term structural ratio designed to address liquidity mismatches. It covers the entire balance sheet and provides incentives for banks to use stable sources of funding.</p>
<p>Principles for Sound Liquidity Risk Management and Supervision The Committee's 2008 guidance <i>Principles for Sound Liquidity Risk Management and Supervision</i> takes account of lessons learned during the crisis and is based on a fundamental review of sound practices for managing liquidity risk in banking organisations.</p>

Leverage Ratio could in fact produce some additional increase in the risk-taking of some financial institutions, that could have incentives to undertake riskier investments due to caps on the amount of leverage,^{21,22} given that this ratio is not risk-weighted.

But as the ECB stated in the same report, this measure is to be understood as being complemented with the synchronic increase of the loss-absorbing capacity due to higher capital requirements, so that risk can only be increased to some more moderate point and it is outweighed by new requirements.

Furthermore, another good aspect of the Leverage Ratio proposed by Basel III includes the off-balance sheet exposure of banks, which is crucial in order to discourage the simple migration of unconstrained risky activities to the off-balance sheet, which would further contribute to the distortionary and difficult problems of shadow banking we have already analysed.

5.2. THE PROBLEMS OF BASEL III

Basel III deals insufficiently with Securitization and it deals insufficiently with Shadow Banking.

Another very big and fundamental problem of both Basel II and Basel III is how the capital requirements are calculated. The system of Risk-weighted assets is imperfect and prone to recurrent mismatches, mispricing of financial assets and problems of “mirages” of sufficient capital requirements that can quickly vanish.

This is evidenced by how most financial entities, both banks and non-banks, had more than enough capital requirements according to Basel II standards at the outset of the financial crisis. Lehman Brothers and other financial companies such as AIG were awash with capital and liquidity by Basel II standards.²³ The miscalculated risk by Basel II and rating agencies of the CDOs and swaps they were operating with transformed into

Supervisory monitoring

The liquidity framework includes a common set of monitoring metrics to assist supervisors in identifying and analysing liquidity risk trends at both the bank and system-wide level.

Source: Bank for International Settlements. International regulatory framework for banks (Basel III).

21 ECB. Financial Stability Review 2015. (Frankfurt, ECB, 2015).

22 Van Riemsdijk, Archie. ECB say leverage ratio makes banks more

stable. (New York: The Wall

Street Journal, 2015).

23 Johnson, Simon; Kwak, James. Capital Requirements Are Not Enough. (New York: The New York Times, 2010).

badly assessed capital solvency through risk-weighted assets system and the panic of contagion when this huge volume of wide-spread securities started to prove non-performing.

Basel III certainly increases capital requirements and makes a somewhat more nuanced distinction of how capital requirements have to be set in respect to Basel II. But the fundamental problems of the Basel frameworks are still in place, and the repetition of similar errors can take place.

Regulators fix the risk weights and the capital requirements of risk-weighted-assets based on predictions of how risky certain assets will be in the future. This system is far from ideal, Doctor Takeo Hoshi²⁴ and the OECD²⁵ have already pointed out the weak spots in terms of information and adequacy of this approach on Basel III.

Not only that, the calculation of risk-weighted assets differs across countries and banking jurisdictions set different criteria,²⁶ increasing the flaws of this system of risk and capital assessment.

Given these problems it would be unwise to be overreliant on the ex ante setting of risk weighted capital requirements, and countries aiming to address the financial system should focus more attention on resolving structural problems of the financial markets, instead of focusing on institutional accommodation.

Also, (but this is not a problem attributable to Basel III) some countries are falling behind schedule in the implementation of Basel III, which already sets a slow calendar of implementation. This adds even greater potentiality of turmoil and makes the Eurozone countries (which belong to the Banking Union) even more unprepared to face a new crisis.

This is arguably because the implementation of the Banking Union requirements which act accordingly with Basel III can cause short-term distress in national banking sectors. That has been the case of Italy²⁷ and its fragile banking system charged with huge amounts of Non Performing Loans, where economic prospects are bad and the prospects of new bail-in procedures along with the pressure put by the increase of capital requirements are having the Italian government considering a public

24 Hoshi, Takeo. (2012). Implementation of Basel III in the US will bring back the regulatory arbitrage problems under Basel I. (London: VOX, 2012).

25 Bundell-Wignall, Adrian; Atkinson Paul. Thinking beyond Basel III: Necessary solutions for capital and liquidity. (Paris :OECD, 2010).

26 Le Leslé, Vanessa; Avramova, Sofiya. Revisiting Risk-Weighted Assets. (Washington D.C.: IMF, 2012).

27 The Economist. Borrowed Time. (London: The Economist, 2016).

bail-out of some banking institutions²⁸ before there is an effective run and then bail-in mechanisms kick in, when the damage is already done.

These problems show how the European mechanisms set to look after the stability of the financial system do not adequately respond to the prevention of financial turmoil, since the already very limited funds of the Single Resolution Fund can only be triggered after an 8% writeoff on shareholders, creditors and depositors.

6. THE EURO SYSTEM AND ITS PROBLEMS

No comprehensive study of the financial markets and regulations of the Eurozone would be complete without appropriate treatment of the Euro, given the narrow relation between financial markets and monetary economics. My analysis of this part is greatly influenced by the academic work of Doctors Barry Eichengreen,²⁹ Jay Shambaugh,³⁰ Larry Neal & Daniel Barbezat³¹ and Ferran Brunet.³²

I argue that the Eurozone's financial problems greatly stem from the fact that the Eurozone is not an Optimal Monetary Area, and it was not constructed as such.³³

6.1. THE PROBLEMS

1. The Euro was the most relevant systemic cause at the European level that led to increasing economic imbalances during the period 1999-2008 between Core and Periphery, given that the unified interest rate of the ECB had to be lowered in order to generate a monetary expansion to fight the recession and deflationary pressures of Germany and Italy during the first part of the period.

Nonetheless, this produced in turn huge inflows of capital

²⁸ Financial Times. Why Renzi's latest bank rescue matters far beyond Italy. (London: FT, 2016)

²⁹ Eichengreen, Barry. *The European Economy Since 1945: Coordinated Capitalism and Beyond*. (Princeton, New Jersey: Princeton University Press, 2008).

³⁰ Shambaugh, Jay C. *The Euro's Three Crises*. (Washington D.C.: Brookings Papers on Economic Activity, 2012).

³¹ Neal, Larry; Barbezat, Daniel. *The Economics of the European Union and the Economics of Europe*. (Oxford, UK: Oxford University Press, 1998)

³² Brunet, Ferran. *Convergence and Divergences in the European Economy: Rebalancing and Being Competitive in a Non optimal Monetary Union*. (Alcalá de Henares: Universidad de Alcalá, 2013).

³³ Neal, Larry; Barbezat, Daniel. *The Economics of the European Union and the Economics of Europe*. (Oxford, UK: Oxford University Press, 1998). Chapter 7: The European Monetary System.

and credit to the peripheral countries from the Core (given that returns in these countries were higher on average) and a growth model excessively based on credit (the indebtedness of the peripheral countries' private sector reached record levels) and where salaries could rise at higher rates than overall productivity gains. Other factors such as reforms in the education system which indirectly incentivised drop-outs from education, with the consequent loss of human capital potential, hindering the possibilities for future productivity growth.

In other words, the Euro generates the incentives for slower productivity growth which was (and is) supposed to fight. The Euro created structural distortions, it generated an incentive distortion in peripheral countries towards the non-tradable sector, to the detriment of the tradable sector, which is usually the sector that is more internationally productive and has greater productivity gains.

That is the main reason why productivity gains in the periphery have actually diminished after the introduction of the Euro, as James A. Caporaso and Martin Rhodes treat in their book *Political and Economic Dynamics of the Eurozone Crisis*.

Table 4.1 Conformity of the Peripheral Countries to the Competitiveness Argument

Question (indicator)	Greece	Ireland	Italy	Portugal	Spain
Does the growth in relative real unit labor costs increase after the introduction of the euro?	NO	YES	YES	NO	NO
Does the appreciation of the relative real effective exchange rate increase after the introduction of the euro?	NO	YES	YES	NO	YES
Does the growth in the relative GDP price deflator increase after the introduction of the euro?	NO	YES	NO	NO	YES
Does labor productivity growth decline after the introduction of the euro?	NO	YES	YES	YES	YES
Does total factor productivity growth decline after the introduction of the euro?	NO	YES	YES	YES	YES
Does the growth in real exports of manufactured goods decrease after the introduction of the euro?	NO	YES	YES	YES	YES
Does employment in manufacturing decrease after the introduction of the euro?	NO	YES	NO	YES	YES
Does the current account move (deeper) into deficit after the introduction of the euro?	YES	YES	YES	YES	YES
Does the central bank's borrowing from the euro system through TARGET2 increase with sudden changes in the current account position?	NO	NO	NO	NO	YES

Source: Caporaso, James; Rhodes, Martin. *Political and Economic Dynamics of the Eurozone Crisis*. (Oxford, UK: Oxford University Press, 2016).

These processes have favoured the export-led models of Germany and the DM countries and its corporations, based mostly on external competitiveness growth, and led to huge macro-economic imbalances - such as excessive capital account surpluses in DM countries (superior to the maximum 6% determined before a Macroeconomic Imbalance Procedure by the EU) and which put at great risks the stability of the Euro Area and which also affects the global trade.

All in all, as the Euro cannot accommodate different inflation differentials it becomes de facto a neo-mercantilist system, it generates the enrichment of a national member through the impoverishment of others, and it can well imply a race to the bottom to gain competitiveness. What is meant with race to the bottom is that this competitiveness gains do not have to be based on real increases in productivity. Economic adjustments may suffice like currency devaluation or internal devaluation. In the Euro area the only possibility is internal devaluation as an adjustment, through salary reductions and dismantling of workers' rights and its associated labour costs.

But this is a competitiveness gain only in appearance, as much as currency devaluation are gains only in appearance, but the difference is that currency devaluation has far less disruptive and hindering economic effects in the long run,³⁴ specially on the human capital, which can greatly degradate. Internal devaluation and its related policies do not mean a growth model change at all, it is just an adjustment mechanism to improve the external condition of an economy. It definitely entails a redistribution of labour relations in favour of companies, which is in itself a questionable objective for economic policy, but it has nothing to do with a healthy change of growth model.

The paradigmatic example that refutes claims that internal devaluation improves the economic model is Finland. There is an extended economic misconception between inadequate exchange rate problems and model growth problems, and Finland shows the difference between the two.³⁵ It has a great economic, innovative and social model, but it is immersed in a prolonged depression and a consistent negative economic output gap due to its incapability to quickly respond and adjust to negative shocks due to the inability to devalue.

Even further, this is not only the case of Finland. The whole

³⁴ Krugman, Paul. Iceland, Ireland, and Devaluation Denial. (New York: The New York Times, 2015).

³⁵ Evans-Pritchard, Ambrose. Finland's depression is the final indictment of Europe's monetary union. (London: The Telegraph, 2015).

Eurozone is at a negative output gap, but peripheral countries show the biggest negative output gaps³⁶ of all due to the destructive economic policies that have been followed. They have problems in their growth model, but internal devaluation has not improved them. The lack of empirical evidence for claims of internal devaluation leading to better economic models is outstanding, it simply does not resist a critical economic approach.

So in summary, the Euro Area is intrinsically not a healthy system for economic development and social welfare, with the associated gains of a monetary union (reduction of transaction costs, of currency volatility, etc.) greatly outweighed by its costs due to the inflexibility of adjustments, which were present in the 1979-1986 period of the EMS.

Furthermore, it is certainly not possible to solve its members productivity issues in comparison with other advanced economies with a monetary system that gives structural incentives for cycles of lower productivity gains and subsequent dismantling of workers' rights and conditions to compensate them.

2. The implications of the Euro's problems change the structure of the European financial markets. In order to palliate the effects of the credit and real estate bubbles and the sovereign debt-crisis on the financial system, a policy of banking concentration in the peripheral banking systems has been pursued, in order that they can respond better to negative shocks, not because they are necessarily a better structure for the banking system. Germany's banking system follows a model of extended regional and local entities which mix political and financial direction, much like the case of Spain prior to the failure of the system of "Cajas"

3. The Euro makes inevitable the use of new but imperfect expansionary monetary tools like Quantitative Easing in order to palliate deflationary pressures and recession. They directly affect financial markets and generate their own financial distortions of excess of capital and liquidity in some countries and in some sensitive economic sectors of the Eurozone and the European Union, as Wolfgang Schäuble acknowledges.³⁷ *Id est*, housing and credit bubbles have been taking place in Nordic and Core countries. Germany is experiencing a housing bubble right now, it was one of the few countries that did not have a real estate and credit bubble during the period 1999-2008). Nordic Countries such as Den-

³⁶ Economy Watch. Output Gap, Percent of Potential GDP Data for All Countries. (Singapore: Economy Watch, 2016).

³⁷ The Independent. German Finance Minister Wolfgang Schaeuble Warns of Market Bubble.. (London: The independent, 2015).

mark and Sweden (although it is out of the Eurozone its intimate relation with the Eurozone system generates great inflows of capital and credit to Sweden) private indebtedness is sky-high and has incremented during the general downturn of the eurozone as returns in these countries are better and safer now than in peripheral countries.

These cycles of increased imbalances would make that in a new significant financial crisis, the economies and governments of the Eurozone would be ill-prepared to respond. Not only because they have wasted a whole cycle of global growth since 2008-2009 due to the systemic causes of its monetary system (and the structural problems of low growth, high public debt and high public deficits).

What could also happen is that the countries that were able to maintain a certain equilibrium (like Germany, the DM area and the Nordic countries) of the whole Euro system through transfers and their contributions to European stability mechanisms (like the European Stability Mechanism for troubled countries) could not be able to further maintain the stability of the system, given the detonation of their own mounting economic problems.

All these reasons lead me to think about the importance of the Euro in the dissertation, given that it treats whether the mechanisms and financial regulations that have been developed would be adequate and sufficient to prevent a new economic crisis, and I must say that I think they are clearly insufficient, and due to a large extent to the Euro system.

7. CONCLUSIONS AND SOLUTIONS

7.1. STRUCTURAL AND HISTORICAL CONSIDERATIONS

The research question of this work has been: “Are the regulatory changes implemented in the EU’s financial system effective to avert a new economic crisis in Europe?”. In light of the data, the facts, and the historical events and my interpretation of them I would strongly argue that they will not be effective to avert a new financial and, in turn, economic crisis.

All things considered, I think we definitely should not just contemplate merely regulatory changes in the financial system in order to avoid future economic crises in Europe. The answer has to deal structurally with economic and political matters of the

Eurozone and the European Union, and this implies inevitably a reshaping of dominant economics.

The European Union is historically a response from top national business and political leaders of Western Europe to the Eurosclerosis of the EEC during the 1980s, a period which meant economic stagnation of Western Europe relative to that of the USA and Japan, the two other undisputed heavyweights of the world economy at that time.³⁸

Deregulation and liberalisation have been pursued in the European Union through the political impulse for an internal market at the highest national political ranks, well before the European Union came to exist, already with the pillars of the European Integration process.

From a more global standpoint on the liberalisation and deregulation process, since the outburst of the crisis and at a very slow pace, dominant economic ideology and political economy has undergone an ideological reform³⁹ from its previous form of neoliberalism. Just recently, on June of 2016 the IMF published an article dealing critically with the negative aspects of neoliberalism from its Deputy Director of the Research Department. This is indeed an event worth noticing, it shows a gradual ideological change in very important international organisms, and its consequences can now slowly extend to the “orthodox” policymaking, which had the Washington Consensus as a key piece for global economic reform.

The article explains the good aspects of economic openness but also the detrimental effects of excessive liberalisation, specially of excessive financial liberalisation, and the inequality and growth and public problems that significant neoliberal policies have had during recent years.

A change in this direction of the dominant economic ideology and political economy is definitely needed if we try to heal the economic and social problems of Europe and achieve more balanced economic and monetary systems for the future.

7.2. SOLUTIONS

By now we have a synthetic and all-encompassing view of the notoriously difficult entanglement the Eurozone and the EU

³⁸ Eichengreen, Barry. *The European Economy Since 1945: Coordinated Capitalism and Beyond*. (Princeton, New Jersey: Princeton University Press, 2008). Chapter 11: Integration and Adjustment p. 335-378

³⁹ Ostry, Jonathan D.; Loungani, Prakash; Furceri, Davide. *Neoliberalism: Oversold?*. (Washington D.C.: F&D IMF, 2016)

are caught in. Here I will propose solutions that are internationally and politically very difficult to orchestrate, but which from an economic standpoint I think are the most sensible and reasonable to heal the malaise of the economies of Europe and its citizens. The solutions that I propose fall into 3 main categories:

I. IMPULSE OF BANKING REFORM.

I have already been commenting during the paper that I am in favour of a considerable number of principles and measures that the Banking Union incorporates, such as the Single rulebook, countercyclical buffers, a leverage ratio, the principle of a system more focused on bail-ins than in bail-outs by national governments (although it should be flexible in order to avoid unnecessarily damaging distress) which increase the efficiency and stability of the financial markets and its monitoring. Nonetheless, the new legislations and mechanisms at the EU level do not tackle the structural causes by which both systemic and non-systemic banks were bailed-out by national European governments.

I propose the enactment of measures similar to the Glass-Steagall Act of the 21st Century, as I have previously stated to deal structurally with the problem of the TBTFs and the proliferation of shadow banking. The systemic implications of TBTFs magnify the building-up and the negative effects of bubbles, and causes a reverberation into the real economy.⁴⁰ A separation of conventional banking with other financial activities would help minimise the costs of the side effects of megabanks: avoid distortions in competition and a lesser exposure of systemic companies to way too dangerous booms and sudden busts.

Also, a lot more effort and means have to be put in place in order to better understand shadow banking and its risks in order to develop adequate shadow banking policies and regulations. If not, we let ourselves open to much more uncertainty and potential sharp shocks.

II. FRAGMENTATION OF THE EUROZONE.

In order to have a sustainable and healthy monetary and economic system it is indispensable to carry out the fragmentation of the Euro. This fragmentation would mean

⁴⁰ Smith, Yves. *Why Larry Summers is Wrong and Bernie Sanders is Right on Glass-Steagall*. (New York: Naked Keynesianism, 2016).

the biggest benefits and the least short-term costs if it was an arranged break-up

An organised break up would involve establishing the procedures for the abandonment of the Euro, and the reform of the treaties to make the Euro non-mandatory for EU members. It would also entail the creation of a committee formed by economists designated by the different states of the Eurogroup to deal with the most technical aspects of the reintroduction of the new currencies and the redenomination of different prices.

Arguably, the Euro could continue to exist as the currency of the Deutsch Mark area -Germany, Austria, the Netherlands, Belgium and Luxembourg - which is an optimal monetary area and the benefits of a monetary union would not be offset by its rigidity costs.

In turn, other countries that are arguably optimal currency areas could create new transnational currencies. For example Nordic countries like Denmark (in the ERM-II, Finland and/or Sweden (currently using the Swedish Krona). The fragmentation of the Euro does not mean necessarily a complete return to the previous European monetary system of exclusively national currencies. The key about determining what more adequate “Monetary Sub-unions” could be implemented lies in how synchronized (including real convergence) and interconnected are already the countries in consideration.

III. RECUPERATION OF THE PUBLIC CENTRAL BANK AUTHORITY FOR ADEQUATE QE TO ENHANCE PRODUCTIVITY

We have seen how the ECB has been forced to lead the breaking of the central banking orthodoxy. It has enacted increasingly more heterodox monetary policies to palliate the intrinsic defects of the Euro system.

Recently it has embarked on monetary financing, or QE for non-banking companies. It has showed how the central bank can increase immensely its balance sheet without causing inflation (alas without sufficient growth).

The ECB and/or the new central banks that would be put in place during the fragmentation of the Euro ought to keep pursuing monetary financing or Quantitative Easing, but they should do so publicly and on projects to enhance the European countries’ productivity.

Monetary financing is an extremely useful tool for economic and productive development, but it is hugely misused. A public central bank with price stability rules, of around 3% or 4% maximum of inflation (which are reasonable for an advanced economy) and a minimum of 1% coupled with the use of monetary financing to fund these projects free of cost by the governments would be an incredibly useful economic tool, specially for hard-hit European economies of the periphery.

Democratic accountability would be necessary, given that the central banks would not simply be agencies of administering interest rates and overseeing financial requirements and supervision, etc. There would be the need to follow some public guidelines, which would imply a reform of article 130 of TFEU or, if not possible, abandon the EU but keep being part of the European Economic Area and the internal market.

These price stability rules along with projects to enhance productivity could materialise for example in trans-European projects of Research & Development and infrastructure, needed to improve the economic performance of the European countries.

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European Identity

4. 1. The Far-Right Challenge to the EU: Recapturing the EU Narrative

SUBMITTED BY

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1. INTRODUCTION

*“The European Union has slowly been eroding Europe’s nation-states by gradually dismantling their sovereignty. It has robbed our countries of the right to conduct our own national asylum policies.”*¹

The far-right is mounting a serious challenge to the legitimacy of the European Union. Against the vision of a more integrated, liberal, and social democratic Europe, the far-right is gaining traction with its narrative of authoritarian nationalism. This vision has gained an outsized influence over European Union discourse due to social and economic insecurity. We aim to understand the far-right narrative, the reasons why it has gained traction, and how the European Union can recapture the attention and support of the public with a strong narrative.

The far-right has three common elements and some

¹ Wilders, Geert, Marine le Pen, Matteo Salvini, and Heinz-Christian Strache. “Restoring Europe’s Borders & Sovereign Nations.” Wall Street Journal. 15 Oct. 2015. Web.

important differences. First, like the far-left, it is anti-establishment. Second, unlike the far-left, they direct dissatisfaction for the problems of the establishment on outside groups, especially minorities and EU institutions. Third, they support some degree of authoritarian nationalism. But there is also significant division. Some are openly illiberal, ultra-nationalist, and openly espouse racist rhetoric.² Others have modernized their narrative and frame themselves as protectors of the liberal state and national identities against outside threats.³

The far-right influence over the European Union discourse far outstrips their popular support. Their popular support and parliamentary representation is not that large in the EU parliament or most EU countries. In the European Parliament, at least seven member-states will contain far-right representatives contributing to a total of at least thirty-six Members of Parliament in the Europe of Nations and Freedoms group.⁴ But these are paltry numbers relative to other groups in the Parliament. In addition, the vast majority of the growth comes from the French far-right. Democratic structure allows for the far-right to have the support it does in the EU parliament.

There are two tangible factors that have driven the rise in influence of the far-right's narrative: (1) an unintegrated European level economic policy that has forced countries to adopt painful measures in order to cope with economic shocks and insecurity, and (2) tension around immigration. Europe is experiencing a period of uncertainty in both areas that has perpetuated anti-establishment sentiments. There is a broad sense that the establishment has not been able to cope with emerging political problems. An inability to generate strong integrative policies with popular backing in these areas has largely driven this. That has translated into support for the far-right since their platform of authoritarian nationalism promises more security.

The economic strain of the debt crises have given the far-right an influential economic platform. The failure of current establishment policies to handle the crisis have made them look economically pragmatic. However, many of these failure have their roots in the lack of integration and the existing economic inequality. Economic policies that integrate European fiscal

2 Bremmer, Ian. "These 5 Facts Explain the Worrying Rise of Europe's Far-Right." Time 15 Oct. 2015. Web.

3 As of writing, the bloc of the far-right in the European parliament led by Marine Le Pen did not include the Greek Golden Dawn or Hungarian Jobbik parties that had been cited for violence or anti-Semitism, respectively. This suggests important division

4 Rubin, Alissa J. "Far-Right Parties Form Coalition in European Parliament." The New York Times. 16 June 2015. Web.

policies while respecting national level concerns should reduce tangible economic insecurity and support for the far-right.

Tensions related to immigration and refugee policies in the EU has strained European social identity and fueled support for the far-right. Speaking with German newspaper Der Spiegel in 2010, Thomas Klau from the European Council on Foreign Relations said the following: “As anti-semitism was a unifying factor for far-right parties in the 1910s, 20s and 30s, Islamophobia has become the unifying factor in the early decades of the 21st century.”

Russia has forged an alliance with far-right parties in Europe in an attempt to weaken the EU and by extension the United States. Many in Russia view the EU as a surrogate of the United States. The United States and EU are seen as proponents of a world order based on technocratic global cooperation whereas the far-right and Russia prefer a return to authoritarian nationalism. As such, many far-right parties have aligned themselves with Putin. Far-right parties have supported Russian intervention against Ukraine on the grounds that the new government is a surrogate of the United States and aligned with the EU. Some far-right parties, most notably in Hungary, have managed to turn the country’s foreign policy away from the West and towards alignment with Russia. The rise of the far-right provides Russia with an opportunity to weaken the EU from the inside out and promote a world order based around authoritarian nationalism.

The rise of the far-right is a symptom of relative unease in Europe, but it may become its own disease if there is no proactive policy that addresses the underlying causes and a forward looking narrative that recaptures EU related discourse. Although the electoral influence of the far-right is small, it can seriously undermine the EU with the sway it has in the discourse. Brexit is a perfect example of this. The insecurity that the far-right is able to utilize for support can be addressed through appropriate integrative measures that respect national level concerns. To that end, the rise of the far-right is also an opportunity to address legitimate concerns that citizens have about the EU and enable the EU to recapture the narrative.

2. DEFINING THE FAR-RIGHT

“Things aren’t what they used to be any more.”⁵

5 Smith-Spark, Laura. “Anger at austerity, immigration feeds far-right’s rise in Europe.” CNN. 9 May 2012. Web.

Far-right parties share a common root in xenophobia and nationalism. Their political beliefs emphasize faith in the superiority of their nationality or “race.” Thus, they all have some degree of xenophobia and blame the problems of the system on outside groups. As a remedy they advocate some degree of return to past traditions. Michael Minkenberg, a professor of political science at Germany’s European University Viadrina in Frankfurt, claimed that he believes the radical right in Europe benefits from a “feeling that things aren’t what they used to be any more.”⁶ And the remedy they draw upon from the past is authoritarian nationalism. Their style of politics reflects this ideology. They thrive off of the fear that comes with insecurity and identity politics. In particular, they feed off the perceived “cultural insecurity” arising from immigration and economic insecurity resulting from rapidly changing circumstances in capitalist economies.

Far-right parties are anti-establishment. They benefit from the fear that establishment is failing to provide adequate security through governance. The perceived failure of the establishment is tied to the degree of control on socio-economic developments and the performance of the nation in the world and not necessarily the long-term economic performance of the country. The fears in the European societies are the effects of two interconnected phenomena. The first identified factor is the advancement of European and political integration and the idea of a multiracial and multicultural society. The second identified phenomenon lies in what Holmes calls ‘fast-capitalism’, where the emphasis on a productive regime ‘transforms the conceptual and the relational power of “society” by subverting fundamental moral claims, social distinctions, and material dispensations.’⁷ These two phenomena form the basis of the current far-right attack on the establishment.

Far-right parties divide societies in at least two groups and prioritize one group at the expense of the “other.” Political scientists David Art, Piero Ignazi and Herbert Kitschelt all list such messages of exclusion as key components of an extreme right party, particularly in Europe. Art lists among his defining features of right-wing populist parties “ethnic conception” of the nation, with pledges to protect it from external threats, as well as “demonizing the Other”, typically implying immigrants.⁸ Ignazi

6 Smith-Spark, Laura. “Anger at austerity, immigration feeds far-right’s rise in Europe.” CNN. 9 May 2012. Web.

7 Holmes, Douglas R.. *Integral Europe: Fast-Capitalism, Multiculturalism, Neofascism*. Princeton: Princeton University Press, 2000. 5

8 Art, David. “Reacting to the Radical Right.” *Party Politics*. 13.3(2007): 331-49.

includes immigration issues as the most important condition for development of right-wing parties within Europe. He also lists an emphasis on “natural community” (in which he implies nationalism and ethnocentrism) as a basic trait of such party’s ideologies.⁹ Finally, Kitschelt delineates the crucial importance of immigration crises as a stimulant for right-wing extremist support, additionally defining such parties with exclusionary definitions of citizenship and the rejection of immigrants from non-European cultures.¹⁰

The strongest driver of the far-right is likely the fear that the other will undermine to cultural basis of the “in” group. In *Who Fears What?*, a 2011 study in *Comparative Political Studies*, the results showed perceived cultural-ethnic threats to be a stronger predictor of far-right preferences than perceived economic-ethnic threats. Cultural threat is defined in the study as “perceived threats that immigrants undermine the cultural life or increase tensions and the evaluation of multiple religions, customs, and traditions within one country.”¹¹

These parties are strongly Eurosceptic and have capitalized on feelings of alienation from the European Union. National policy for the EU’s constituent countries, as exemplified by the European Central Bank’s managing of monetary policy, is increasingly made in Brussels. Policies not just on immigration, but also on topics from environment to agriculture, are exported from the seat of EU institutions. According to Brookings, “the result is a deep sense that the individual nation is losing control of its own destiny. It is a crisis of identity that the far-right skillfully is exploiting with its appeal to the national character and cultural uniqueness and a growing opposition to an integrated Europe.”¹²

But it is not monolithic. Many have modernized and focused on more pragmatic and liberal concerns such as economic sovereignty and protecting national civil society from illiberal Islam. To quote Mammone, an historian on the far-right: “What is clear is that the extreme right is not a mono-dimensional phenomenon but it is a rather ‘rich’ object of examination as well as a somewhat controversial party family.”¹³ The main dividing line

9 Ignazi, P. “The Silent Counter Revolution.” *European Journal of Political Research*. 22(1992): 3-34

10 Kitschelt, Herbert. *The Radical Right in Western Europe*. Ann Arbor: University of Michigan, 1995. 1-45.

11 Lubbers, Marcel. “Who Fears What? Explaining Far-Right Wing Presence in Europe.” *Comparative Political Studies*. 15 Dec. 2011. Web.

12 Daalder, Ivo “The Anti-Immigrant Parties are Racist, Xenophobic, and Intolerant, and Could Undermine the European Union.” *Brookings*. 1 Jun. 2002. Web.

13 Mammone, Andrea. “The Eternal Return? Faux Populism and Contemporarization of Neo-Fascism across Britain, France and Italy.” *Journal of Contemporary European Studies* 17.2 (2009): 171-192. Web. 20 Sep.

is between the “old” openly racist parties versus the “new” parties who proclaim to be protectors of the liberal society against immigrants. While both use Manichaen us vs. them divisions, but the new right views the other as a threat to liberal society. Fear and hope in this sense are centred around the idea of being able to climb the socioeconomic ladder and goes hand in hand with the sense of control citizens have over their ability to pursue their personal goals. The other threatens this control by undermining the social contract. By contrast, Jobbik, and influential Hungarian far-right party more akin to the old right, espouses only racist and anti-semitic rhetoric. While all far-right parties advocate some degree of authoritarianism, “extreme right public discourse no longer questions the basic assumptions of republican, democratic institutions.”¹⁴ Only a few minor parties do so.

For example, in Sweden and Germany the “new” far-right parties have both portrayed themselves as protectors of the liberalism against a Muslim threat. In Sweden, far-right parties have argued the immigration undermines their pension system. They recently released a commercial depicting Muslim mothers running over an old Swedish woman. In Germany, support for the far-right is linked to voters seeking an alternative to Angela Merkel’s more centrist bloc, which temporarily had an open-door policy for refugees. Alternative For Germany was founded three years ago by a group of economists and has fared relatively well in recent elections. It originally formed in opposition to Germany-backed bailouts for struggling Eurozone countries during the debt crisis on the basis that they undermine the viability of the German economy. They have gone so far as to advocate shooting illegal immigrants to protect liberal society.

3. THE FAR-RIGHT AND THE EU: REPRESENTATION IN DEMOCRATIC INSTITUTIONS

The far-right has made a significant surge in parliamentary representation; nonetheless, their surge is much weaker than it appears on the surface. There is a lot of variation across member states and blanket statements about Europe’s swing to the right should be subject to close scrutiny. While pre-elections polling and media coverage of far-right parties at times predicts a much greater victory or gain in the elections, this prediction often does

2016.

¹⁴ Prowe, Diethelm (1994) “‘Classic’ fascism and the new radical right in Western Europe. Comparisons and contrasts.” *Contemporary European History* 3.3: 289–313.

not translate into actual electoral results. Far-right representation has increased in the EU parliament and in several national parliaments. But their representation is still weak and they have significant internal divisions. In addition, the vast majority of the recent gains come from France. Indeed, many far-right parties recently lost representation in the EU parliament. The trend in national parliaments is even worse for the far-right. With a few notable exceptions, far-right influence in national parties has remained stagnant or decreased. Indeed, many parties fair better in EU elections thanks to the relatively open and democratic electoral rules and different extremely low turnout rates.

Country	European Parliament				National Parliament		
	Percent of Vote	Change	Number of Seats	Change	Percent of Vote	Seats	Total
<i>Party</i>	2014	Change	2014	Change	2010-2015	Seats	Total
Austria	20.2	+2.9	4	+2	24.3	40	183
<i>Alliance for the Future of Austria (BZÖ)</i>	0.5	-4.1	0	0	3.53	0	183
<i>Austrian Freedom Party (FPÖ)</i>	19.7	+7.0	4	+2	20.5	40	183
Belgium	6.4	-4.8	1	-1	5.21	4	150
<i>National Front (FNb)</i>	0.0	-1.8	0	0	0	0	150
<i>Popular Party (PP)</i>	2.3	+2.3	0	0	1.51	1	150
<i>Flemish Interest (VB)</i>	4.1	-5.8	1	-1	3.7	3	150
Bulgaria	3.0	-9.0	0	-2	7.3	23	240
<i>Ataka</i>	3.0	-9.0	0	-2	7.3	23	240
Denmark	26.6	+11.8	4	+2	21.1	37	179
<i>Danish People's Party (DF)</i>	26.6	+11.8	4	+2	21.1	37	179
France	25.0	+18.7	24	+21	13.6	2	577
<i>National Front (FN)</i>	25.0	+18.7	24	+21	13.6	2	577
Germany	1.0	-0.3	1	+1	1.7	0	631
<i>National Democratic Party of Germany (NPD)</i>	1.0	+1.0	1	+1	1.5	0	631
<i>The Republicans (REP)</i>	0.0	-1.3	0	0	0.2	0	631
Greece	12.1	+4.4	3	+1	8.02	18	300
<i>Popular Orthodox Rally (LAOS)</i>	2.7	-4.5	0	-2	1.03	0	300
<i>Golden Dawn (XA)</i>	9.4	+8.9	3	+3	6.99	18	300
Hungary	14.7	-0.1	3	0	20.2	23	199
<i>Movement for a Better Hungary (Jobbik)</i>	14.7	-0.1	3	0	20.2	23	199
Italy	6.2	-4.0	5	-4	4.1	20	630
<i>Northern League (LN)</i>	6.2	-4.0	5	-4	4.1	20	630
Netherlands	13.2	-3.8	4	-1	10.1	15	150
<i>Party for Freedom (PVV)</i>	13.2	-3.8	4	-1	10.1	15	150
Romania	2.7	-6.0	0	-3	1.5	0	137
<i>Greater Romania Party (PRM)</i>	2.7	-6.0	0	-3	1.5	0	137
Slovakia	5.3	-0.3	0	-1	4.6	0	150
<i>People's Party - Our Slovakia (ZSNS)</i>	1.7	+1.7	0	0	0	0	150
<i>Slovak National Party (SNS)</i>	3.6	-2.0	0	-1	4.6	0	150
Sweden	9.7	+6.4	2	+2	12.9	49	349
<i>Sweden Democrats (SD)</i>	9.7	+6.4	2	+2	12.9	49	349
United Kingdom	1.1	-4.9	0	-2	0.0	0	650
<i>British National Party (BNP)</i>	1.1	-4.9	0	-2	0.0	0	650

The overall gain of 15 seats in the European Union suggests a success for far-right parties. However, without the gain of 21 seats by the National Front of France, the average loss of six seats in Parliament implies a turn from the general narrative of far-right representation.

Chart 1: Change in representation of far-right parties in national and EU parliament.

As previously stated, there is variation across member states. Some states have seen a decrease of the the far-right, such as Belgium, the Netherlands, and Italy. In other states, like Spain and Portugal, the far-right never emerged. In some others, there is considerable oscillation in terms of far-right popularity over the years and the trends cannot solely be explained by most recent events in Europe. It is only in Poland (since 2005) and

Hungary (where the far-right has had significant presence at least since 1998) that the far-right has translated popularity into power and has managed to form a government. In Finland, in 2015, the Finn’s Party (previously, True Finns) obtained 17.7 per cent of the vote and in Sweden the Sweden Democrats obtained 12.9 percent of the vote in 2014. As a result, both wielded some power in government formation, becoming part of the government in Finland and remaining in the opposition in Sweden.



Chart 2: Visual representation of the change in right wing representation in national parliaments. Source: Aisch, Gregor, Adam Pearce, and Bryant Rousseau. “How Far is Europe Swinging to the Right.” *New York Times*. 22 May 2016. Web. <http://www.nytimes.com/interactive/2016/05/22/world/europe/europe-right-wing-austria-hungary.html?_r=0>.

The far-right superficially appears to have made significant recent electoral gains but a closer look reveals a weaker and more tenuous surge. In the 2014 elections, European far-right parties received 51 parliamentary seats, an increase from the 2009 elections by 15 seats.¹⁵ The Golden Dawn and Sweden Democrats gained parliamentary representation for the first time in the 2014 elections. Yet, five other far-right parties lost all their seats:¹⁶ Bulgaria’s Ataka, UK’s British National Party, Greece’s

15 Mudde, Cas. “The far-right in the 2014 European Elections: Of Earthquakes, Cartels and Designer Fascists.” *The Washington Post*. 30 May 2014. Web. <<https://www.washingtonpost.com/news/monkey-cage/wp/2014/05/30/the-far-right-in-the-2014-european-elections-of-earthquakes-cartels-and-designer-fascists/>>.

16 Mudde, Cas. “The far-right in the 2014 European Elections: Of Earthquakes, Cartels and Designer Fascists.” *The Washington Post*. 30 May 2014. Web. <<https://www.washingtonpost.com/news/monkey-cage/wp/2014/05/30/the-far-right-in-the-2014-european-elections-of-earthquakes-cartels-and-designer-fas>>.

Popular Orthodox Rally, Romania's Greater Romanian Party and Slovakia's Slovak National Party. Out of the 28 member states, less than ten voted in far-right Members of Parliament. A plurality of the Members of Parliament from the far-right came from the French delegates, numbering 24 out of the 51 far-right delegates. The next highest is Italy with five. While far-right parties gained seats in six national delegations, seven far-right parties lost seats.¹⁷ In essence, the recent success of the far-right is the success of the National Front in France rather than a widespread phenomenon.

The far-right presence in the European Parliament is small despite their strong voice. The primary parliamentary far-right block in the European parliament is the "Europe of Nations and Freedoms," a coalition of far-right parties within the European Parliament.¹⁸ Marine Le Pen, the leader of the far-right French nationalist party National Front (FN), is the bloc's leader. This coalition currently contains 35 members of parliament representing the major far-right parties of seven countries: France's "National Front, Austria's Freedom Party, Italy's Northern League, the Belgian Flemish Interest Party, and the far-right Polish party, as well as a British member of the European Parliament who left the United Kingdom Independence Party."¹⁹ Of the 751 members of the European Parliament, these 35 members of parliament represent the "new" far-right response.

The media's coverage of the far-right might contribute to the perception that the far-right is taking over European politics, and albeit it is undeniable that they have gained enormous protagonism in some countries, it cannot be generalized for all member states. The rise of the far-right in the recent Austrian elections contributes to this sentiment and is certainly of concern to Europeans. The Austrian Freedom Party (FPÖ), founded by Nazis, lost the elections by 30,863 votes to Green-endorsed Alexander Van der Bellen and it holds holds 40 of the 183 seats in the National Council. The FPÖ initially accepted the results but

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- 17 Mudde, Cas. "The far-right in the 2014 European Elections: Of Earthquakes, Cartels and Designer Fascists." *The Washington Post*. 30 May 2014. Web. <<https://www.washingtonpost.com/news/monkey-cage/wp/2014/05/30/the-far-right-in-the-2014-european-elections-of-earthquakes-cartels-and-designer-fascists/>>.
- 18 Rubin, Alissa J. "Far-Right Parties Form Coalition in European Parliament." *The New York Times*. 16 Jun. 2015. Web. <<http://www.nytimes.com/2015/06/17/world/europe/far-right-parties-form-coalition-in-european-parliament.html>>.
- 19 Rubin, Alissa J. "Far-Right Parties Form Coalition in European Parliament," *The New York Times*. 16 Jun. 2015. Web. <<http://www.nytimes.com/2015/06/17/world/europe/far-right-parties-form-coalition-in-european-parliament.html>>.

has recently contested the elections.²⁰ Regardless, the reality is that Austrians ended up electing a left-wing, independent candidate, son of two refugees, as their head of state. The evolution of the far-right in Austria should be closely monitored and it is too soon to predict whether after the elections support for this party will increase or decrease, precedent shows a significant variation in far-right support in this country.

In addition, the far-right institutional representation betrays significant internal divisions. Marine Le Pen was quick to exclude the “old” far-right from her coalition. She made clear her coalition will not accept membership from parties that she considers violently far-right. Noticeably absent from this coalition is Greece’s Golden Dawn and Hungary’s Jobbik Party, both of which have lost support within the European Parliament due to rhetoric embracing violence and anti-Semitism respectively.²¹ Thus, even within such a small block they fracture easily, further undermining their tangible institutional influence.

Far-right parties have failed to gain support beyond their EU representation in national parliaments outside of France. Many of the far-right parties have stronger representation within the European Parliament than in their own national parliaments, including in France. As the above table demonstrates, representation in the EU parliaments is generally almost twice that in national parliaments.²²

The institutional structure of the EU, despite criticism of a democratic deficit, actually encourage significant representation of fringe groups that do not have large shares of the popular vote. EU rules allow these groups to organize, receive funding, access speaking time, and lead committees. The threshold for representation in the EU parliament is lower than the average in national parliaments.²³ Thus, while they represent an important challenge to the EU, their tangible influence is much less than their influence over the discourse partially thanks to the democratic structure of the EU.

Therefore, their level of aggressive chest thumping and in-

20 Oltermann, Philip. “Austrian far-right party challenges presidential election results.” *The Guardian*. 8 Jun. 2016. Web. <<https://www.theguardian.com/world/2016/jun/08/austrias-far-right-freedom-party-challenges-presidential-election-reults>>.

21 Stevenson, David. “Europe’s Most Right Wing Country: Where Is the Extreme Right Strongest?” *Mirror*. 6 Jan 2016. Web. <<http://www.mirror.co.uk/news/ampp3d/far-right-most-powerful-europe-4927430>>.

22 Stevenson, David. “Europe’s Most Right Wing Country: Where Is the Extreme Right Strongest?” *Mirror*. 6 Jan 2016. Web. <<http://www.mirror.co.uk/news/ampp3d/far-right-most-powerful-europe-4927430>>.

23 “Small political groups face EU Parliament ban.” *Euroactiv.com*. May 28, 2008. Web. 31 May, 2016. <<http://www.euractiv.com/section/public-affairs/news/small-political-groups-face-eu-parliament-ban/>>

fluence over the narrative far outstrip their actual representation. With a few notable exceptions, most have little support from national parliamentary elections and have marginal representation in the European Parliament. Their tangible institutional power is further weakened by their tendency to fracture between the “old” and “new” far-right. The slight gain in parliamentary seats in the 2014 parliamentary election is achieved on the coattails of the French National Front and represents neither a widespread trend nor unfettered support. With little representation, the far-right members of parliament look to their aggressive loud voice, instead of proportional representation, to be heard.

4. THE FACTORS STRENGTHENING THE FAR-RIGHT NARRATIVE

4.1. SOCIO-CULTURAL FACTORS

4.1.1 IDENTITY: THE PERCEIVED THREAT TO NATIONAL IDENTITIES BY KATE TEPPER

“We want to maintain our own identity. For us, our traditions, customs and culture are unique and worth protecting. This includes our language, our rule of law, democracy and the separation of church and state.”²⁴

Far-right parties have attracted support and gained influence over the EU narrative largely thanks to perceived social insecurity. They perpetuate and feed off the notion that immigration in particular represents a grave threat to European and national identities and hence threaten social stability. They advocate for xenophobic nationalism, a simplistic and narrow version of national identity that has strong appeal to counter the feeling of insecurity. In particular, their message draws sharp distinctions between immigrant Muslims and ethnic Europeans. The migrant crisis serves as “godsend for Europe’s far-right [...] it gives both new and older parties an opening to capitalize on the rising fear of voters that might never otherwise consider supporting them.”²⁵ The far-right parties have seized the opportunity to make a grand claim to saving or preserving national identity. Two parties in particular have achieved large success on

24 TNO Staff. “Austria’s Freedom Party Surges as Controlled Media Keeps Up Barrage of Smears and Lies.” The New Observer. 30 September 2013. Web. <<http://newobserveronline.com/austrias-freedom-party-surges-as-controlled-media-keeps-up-barrage-of-smears-and-lies/>>

25 Bremmer, Ian. “These 5 Facts Explain the Worrying Rise of Europe’s Far-Right.” Time: Global Trade. 15 October 2015. Web.

the heels of such a message, the Front National of France and the FPÖ of Austria.

The French Front National, the most prominent European far-right party, has long stood for xenophobic nationalism. Recently the party message has become even more pronounced in these positions, calling on the government to “stop immigration, strengthen the French identity.”²⁶ Front National policies narrowly define French national identity and are very protective of membership. Their key policies include a reduction in legal immigration to a small fraction of its previous limit, more stringent requirements for French citizenship, a zero tolerance policy on illegal immigration, priority to French citizens regarding employment and housing, a ban on dual nationality for non-Europeans and a fierce promotion of the French language internationally.

The Front National opposes many EU policies in favor of what they claim is an effort to protect a narrow French identity. The FN supports an end to the Schengen agreement and advocates that the French leave the European Monetary Union and the Euro, using fear tactics regarding free movement of so-called dangerous immigrants to reinforce their position.²⁷ On the party website, the EU is desecrated for not achieving a “common European interest”, and claims that France is disadvantaged within the institutional framework are upheld.²⁸ Although the Front National does not explicitly recommend that France leave the Union, prioritization of national identity over European identity is clear. Their opposition to important pillars of EU integration and xenophobia represent a serious challenge to the legitimacy of the EU.

Support for the FN narrative was bolstered by the November 2015 attacks in central Paris that left 130 dead.²⁹ Le Pen held a rally shortly after the attacks in which she referred to the Front National as being the only party that could reassure France at a time of “infinite sadness” and stated, “France and the French are no longer safe.”³⁰ She has argued that Islam and immigration are

26 The Official Website of the Front National. Web. <<http://www.frontnational.com/le-projet-de-marine-le-pen/politique-etrangere/notre-politique-etrangere/>>

27 France 24 staff. “What does France’s National Front stand for?” *France 24*. 28 May 2014. Web. <<http://www.france24.com/en/20140528-france-national-front-policy-eu>>

28 “Our Foreign Policy.” The Official Website of the Front National. Web. Translated by the Author. <<http://www.frontnational.com/le-projet-de-marine-le-pen/politique-etrangere/notre-politique-etrangere/>>

29 Sykes, Selina. “How Paris attacks could boost support for Marine Le Pen’s far-right Front National.” *Express UK*. 4 Dec. 2015. Web. <<http://www.express.co.uk/news/world/624443/Paris-attacks-Marine-Le-Pen-far-right-Front-National-France-politics>>

30 Zeitvogel, Karin and Anna Gawel. “Immigration, Insecurity Fuel Rise of the Right in Europe.” *The Washington*

directly related to terrorism.³¹ Marine Le Pen was recently on trial for comparing recent waves of immigration to the Nazi occupation. She blamed the attacks on both government inaction and “crazy, undiscerning immigration policy.”³² The FN under Le Pen since vowed to markedly tighten border controls following the attacks, as well as immediately stopping acceptance of new migrants and removing French citizenship from those who carry dual citizenship.³³ For the FN, Islam as a whole is a threat to cultural identity and hence causes social insecurity. They have capitalized on recent events to feed this perception of social insecurity.

The Freiheitliche Partei Österreich (The Austrian Freedom Party, or FPÖ) is a prime example of a far-right party that, similarly to the Front National, has experienced unprecedented support as a result of the perceived social insecurity brought on by the recent migrant crisis. In elections held in September 2015 in Upper Austria, the FPÖ *doubled* their previous vote share, from 15.3 percent in 2009 to 30.4 percent.³⁴ The FPÖ campaign concentrated on anti-immigration and anti-“Islamization” messages, including a Hungarian-esque border fence within Austria and much stricter border controls. Furthermore, they referred to the “forcing” of towns to take in many refugees as the issue that angered their voters the most.³⁵

In the past, the FPÖ gained momentum with their anti-establishment and anti-Islam views, promoting “common sense”³⁶ as well as “preservation of identity, culture and autonomy”. Preservation of the Austrian identity in the eyes of the FPÖ involves promotion of European values above non-Western. Their party demands included a complete stop to immigration from outside European borders, “no place for radical Islam,” proper preservation of national sovereignty and opposition to Turkish membership to the EU, as well as a larger promotion of the German

Diplomat. 24 Nov. 2015. Web. <http://www.washdiplomat.com/index.php?option=com_content&view=article&id=12736:-immigration-insecurity-fuels-rise-of-the-right-in-europe&catid=1538&Itemid=562 >

- 31 Nossiter, Adam. “Marine Le Pen’s Anti-Islam Message Gains Influence in France.” *The New York Times*. 17 Nov. 2015. Web. 20 Mar. 2016.
- 32 Chrisafis, Angelique. “Marine Le Pen’s Front National makes political gains after Paris attacks.” *The Guardian*. 1 Dec. 2015. Web <<http://www.theguardian.com/world/2015/dec/01/marine-le-pen-front-national-political-gains-paris-attacks>>
- 33 Zeitvogel, Karin and Anna Gawel. “Immigration, Insecurity Fuel Rise of the Right in Europe.” *The Washington Diplomat*. 24 Nov. 2015. Web.
- 34 Zeronian, Sarkis. “Freedom Party of Austria Surges in Local Elections, Boosted by Migrant Crisis.” *Breitbart London*. 28 Sep. 2015. Web.
- 35 Hall, Melanie. “Austria’s Right-wing populist party makes huge gains fueled by migrant crisis fears.” *The Telegraph*. 28 Sep. 2015. Web.
- 36 Morris, Marley; Andreas Mölzer, Franz Obermayer, Ulrike Lunacek and Lena Kolarska-Bobinska. “Populist snapshots: Austrian Freedom Party in the European Parliament.” *OpenDemocracy*. 11 Jun. 2014. Web.

language within the national media.³⁷ Their “respect our boundaries” mission seeks to eliminate the influence of “outsiders” from European Union politics. Platforms from the party accuse other parties of doing “little to protect Austrian identity.”

The British National Party was an important force behind Brexit despite having little electoral success. It uses anti-immigration messages, as well as a Brexit-centered strategy to seemingly improve and preserve the British national identity. On the BNP website, they use the slogan “Britain’s full and it’s time to shut the door!” in order to indicate a stop to most outside immigration and to support a British exit from the EU in efforts to “take back control of [their] borders”.³⁸ In their 2014 elections manifesto, the BNP calls for an “immediate, unconditional withdrawal” from the Union, predicting a swift demise for the EU and citing restoration of national sovereignty as their chief reason.³⁹ The BNP prioritizes a single guiding principle in their foreign policy tactics — British interests above all else. This is a party that prioritizes the opposition of Muslim influence very heavily; the BNP has led active campaigns against the establishment of mosques, the hijab, halal food, and what they call the “Islamification” of the United Kingdom.⁴⁰ It is incredibly troubling to the EU and to a collective European identity to have far-right parties that imply that exiting the Union would lead to a preservation of national identity. The BNP mixes xenophobia with nationalism to work, in a way, against the European identity. They use a message that implies that national traditions are desecrated and British citizens become outsiders within their own borders within a more inclusive European Union.

4.1.2 ISLAMOPHOBIA, TERRORISM, AND THE EU

The type of Islamophobia advocated by the far-right has become a major social trend. This kind of Manichean divisiveness has resulted in wide fissures between Muslim immigrants and the remainder of European society, partially due to the lack of a clear effort to integrate and protect the rights of Muslims. In addition, European wide counter-terrorism policies influenced by the far-right’s divisions have been poorly targeted and self-defeating.

37 TNO Staff. “Austria’s Freedom Party Surges as Controlled Media Keeps up Barrage of Smears and Lies.” *The New Observer*. 30 Sep. 2013. Web.

38 Official Website of the BNP. Web. <<http://www.bnp.org.uk/>>

39 “British National Party European Elections Manifesto 2014.” Official Website of the BNP. Web <http://www.bnp.org.uk/sites/default/files/bnp_eu-manifesto-2014_o.pdf>

40 “British National Party.” *Hopenothate.org*. <<http://www.hopenothate.org.uk/hate-groups/bnp/>>

Partially due to far-right influence, Islamophobia, anti-Islam “prejudice, discrimination, and hatred,” is a major social trend throughout Europe.⁴¹ As shown above, the far-right lumps Islam and terrorism together. Islam has become their main “out” group. Recent terrorist attacks have fed their narrative of Islam as the “other” and resulted in widespread Islamophobia. Their worldview simplistically equates Islam with terrorism or with illiberalism. This worldview has attracted significant support and thus widened social fissures. In Italy, Denmark, Luxembourg, Britain, Germany, and many other countries, the Muslim minority faced verbal and physical abuse, vandalized houses, and bomb and death threats, as described in the *Summary Report on Islamophobia in the EU after 11 September 2001*.⁴² Visual markers, like headscarves on women or skin tone, became reason enough to target or mistreat someone, regardless of that person’s connection to Islam. The ensuing xenophobia has resulted in physical and verbal attacks, and even the dropping of pigs’ heads next to Mosques.⁴³

But the European Union and national governments have failed to set a clear legal and policy structure that contains Islamophobia. Although the founding documents of the EU repeatedly support human rights and equality, the policies and actions of European governments have not supported Muslim integration. Twenty-three million Muslims currently live in Europe, excluding Turkey, yet nearly a dozen European countries fail to officially recognize Islam as a religion.⁴⁴ This leaves the Muslim minority without sufficient rights protections and prevents the population from fighting against discriminatory practices. As one scholar noted, “EU law dealing with terrorist offences speak little of this backlash that Muslims face in European countries. Although the EU has somewhat of a framework in place which concerns the protection of Islamic identity, the reluctance of the EU to take a determined stance on the issue of the protection of religious identity is illustrated through the ambiguous nature of its legislation.”⁴⁵ Thus, the lack of a clear integrationist stance by the EU has made it difficult to contain Islamophobic backlashes.

41 Allen, Christopher. “Justifying Islamophobia: A Post-9/11 Consideration of the European Union and British Context.” *The American Journal of Islamic Social Sciences* 21.3 (2004): 1-25. Web. 20 Mar. 2016.

42 Ibid

43 Witte, Griff. “French Muslims Caught between Islamophobia and Extremism.” *Washington Post*. The Washington Post, 22 Mar. 2015. Web. 19 Mar. 2016.

44 Gündüz, Zuhale Yesilyurt. “The European Union at 50—Xenophobia, Islamophobia and the Rise of the Radical Right.” *Journal of Muslim Minority Affairs*, 30:1 (2010): 35-47.

45 Ahmed, Tawhida. “The EU, Counter-Terrorism and the Protection of Muslims as European Minorities.” *International Community Law Review*, 13: 4. (2011): 437

In addition, poorly targeted EU counterterrorism policy has increased social polarization and undermined themselves. It includes measures to stop, search, and examine people at seaports, airports and other designated areas. The young demographic profile of Muslims, their ethnic composition, and low socioeconomic status mean that Muslims are disproportionately targeted by these measures.⁴⁶ The ill effects of these discriminatory practices came to light in the reflections of focus groups across the continent. The focus groups also revealed further negative interactions with police that actively undermine counterterrorism policy and increase polarization. Muslim participants consistently reported a failure to respond to their police reports, bullying or abuse from individual officers, and a weak procedure for dealing with hate crimes against Muslims.⁴⁷

The failure of several EU member states to successfully integrate the growing Muslim populations creates tension that polarizes Muslim and non-Muslim groups,⁴⁸ This polarization fuels support for the far-right narrative, which in turn further widens social fissures. As discussed above, their narratives portray Muslims as causes of social problems. The growth of Islamophobia in Europe has resulted in excessive and poorly targeted anti-terror policies that have also created more polarization. The far-right's attempts to fracture the population along ethnic divisions undermine the European Union's pillars of legitimacy of unity, social cohesion, and economic inclusion.

4.2. INCREASED ECONOMIC INSECURITY, POLICY MISTAKES, AND FALSELY DE-POLITICISED ECONOMIC POLICYMAKING UNDERMINE THE LEGITIMACY OF EUROPE'S INSTITUTIONS

The European far-right was strengthened by three interconnected economic factors over the last decade: the financial and sovereign debt crisis washing over Europe since 2008, and the Eurozone in particular since 2009/10; the faulty European economic policy response to these crises; and, at a deeper level, perhaps the very structure of economic policy making in Europe. As a result of these three factors, the liberal economic narrative at the heart of the European Union has lost some of its credibility, while the nationalist, protectionist, and xenophobic economic narrative of the far-right has been able to gain ground. This shift in the credibility of different economic narratives has, given

⁴⁶ Gündüz.

⁴⁷ Ibid

⁴⁸ Bures, Oldrich. "Perceptions of the terrorist threat among EU member states." *Studies* 46.1 (2008): 7.

the close association between economic narratives and particular parties and institutions, in turn directly contributed to the rise of far-right parties and groups.

Taking the three factors one by one, first, the sudden shock of the 2008 financial crisis, compounded by the deeper structural changes currently taking place throughout the industrialized world, greatly increased economic insecurity for many throughout Europe. Driven by stagnant or falling real wages (chart 1) and persistently high unemployment (chart 2), a sense of pervasive economic uncertainty took hold throughout much of Europe. It

Inflation-adjusted gross and net earnings in the EU, 2001-2014

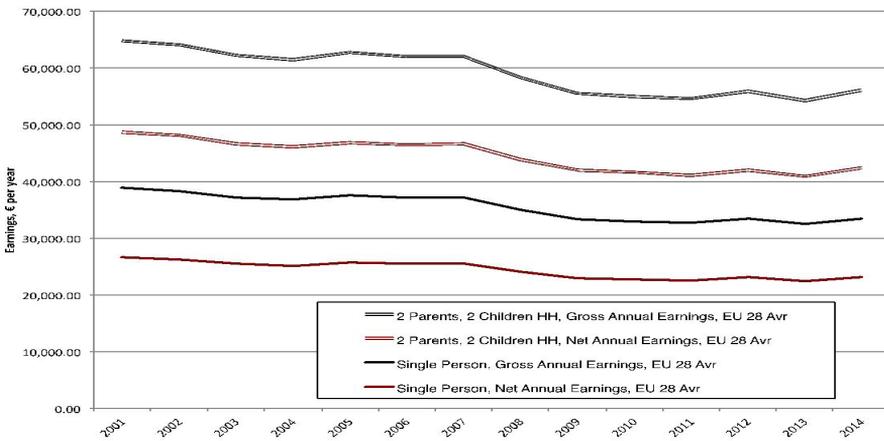


Chart 3: Inflation-adjusted gross and net earnings have fallen across the European Union since 2001. Source: author, based on Eurostat data. Earnings data from series 'Annual net earnings,' code 'earn_nt_net'; inflation data from series 'Harmonized index of consumer prices, 2015 = 100,' code 'prc_hicp_aind'

Monthly unemployment as per cent of the active population across the US, the UK, the Eurozone, and the Eurozone with Germany stripped out

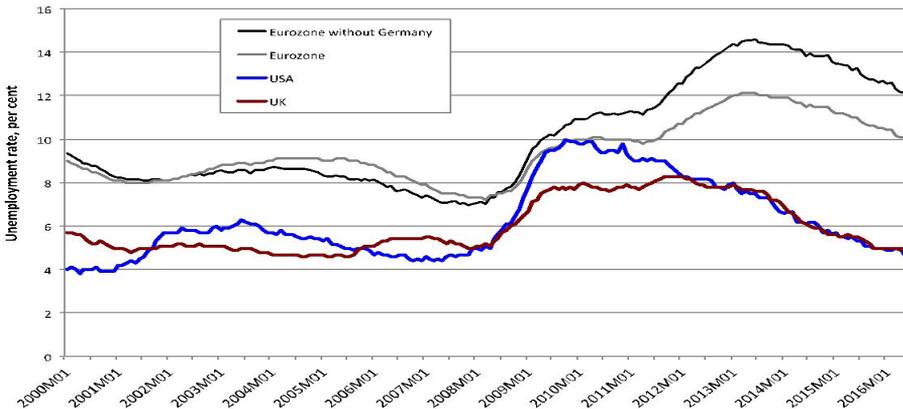


Chart 4: Unemployment in the Eurozone, especially when Germany is stripped out, has risen higher and fallen slower than in the US and the UK. (Source: author, based on Eurostat data, series 'Unemployment by sex and age - monthly average,' code 'une_rt_m')

is notable that the fall in real earnings captured in chart 1 significantly pre-dates the 2008 crisis, though it has accelerated in its wake. A focus on GDP, which as opposed to earnings (i.e. ultimately wage) was rising prior to 2008, obscures this longer-term aspect of economic malaise for many, though not all, Europeans.

Further, and possibly as a result of the fall in earnings and rise in unemployment charted above, citizens in Germany, France, the UK, Italy, Spain and a number of other European countries have become convinced⁴⁹ (often with good reason)⁵⁰ that the next generation will be economically worse off than the previous one. This quickly fosters a sense of disappointment and resentment against those in the previous generation responsible for economic policy making, which may go some way towards explaining the surprising attractiveness of far-right parties even to younger generations.⁵¹

Finally, while rising inequality is also an issue,⁵² its growth has been less pronounced in Europe than in the US,⁵³ and again less so in continental Europe (where the rise of the far-right has been most prominent) than in the UK.⁵⁴ It is thus more appropriate to identify rising insecurity, as proxied by high unemployment rates, as the prime economic effect of the economic crises

49 The data on this is somewhat patchy. However, Pew surveys for Britain, the Czech Republic, France, Germany, Greece, Italy, Poland and Spain show that only a minority of people currently believes that the next generation will be better off; and that this minority has gotten progressively smaller over the last decade or so: from 31% in 2002 to 25% in 2015. With Germany taken out of the sample (where the numbers have increased, from 25% in 2002 to 34% in 2015), the fall is even more pronounced, from 34% in 2002 to 22% in 2015. Percentage figures refer to the percent of people who answered 'yes' to the question "When children today in (survey country) grow up, do you think they will be better off or worse off than their parents?" Source: author's calculations based on Pew Global Attitudes and Trends Question Database, questions 1625 and 1036).

50 See for example the well-documented case of the UK, where there is a possibility that "millennials face becoming the first generation on record to achieve lower lifetime earnings than their predecessors." (p.6, Gardiner, Julia. "Stagnation Generation. The case for renewing the intergenerational contract." Resolution Foundation and Intergenerational Commission Report. July 2016. Available online at <http://www.resolution-foundation.org/wp-content/uploads/2016/07/Intergenerational-Commission-launch-document.pdf>). However, it is hard to generalize from the British case: on the one hand youth unemployment is lower than in many other European economies, suggesting that the situation may be just as bad or worse there; but on the other hand the UK housing market is playing a large role in the difficulties facing 'millennials,' suggesting (since other housing markets are not similarly stressed) that the UK may be a negative outlier.

51 Note for example a recent survey that see Marine Le Pen tied for first place amongst voters 18-25 years old. Survey conducted by the French Institute for Public Opinion (IFOP), for the National Association of Child and Youth Councils (ANACEJ) in France, April/May 2016. Poll not public, but coverage in *Le Monde* (3 May 2016, Eric Nunès, "Sondage : la jeunesse tourne le dos à François Holland") contains the key result: Le Pen, 27-31%; Juppé (centre-right), 29%, Mélenchon (left), 15-19%, Hollande (centre-left), 13-15%.

52 See Figure 9.8., Piketty, Thomas. "Capital in the 21st Century." Harvard University Press. 2014. The share of the top decile in total income, averaged over the four European countries with the best data availability (France, the UK, Germany and Sweden) has risen from below 30% in the 1970s and 1980s to just below 35% in 2010, an increase of 16 per cent.

53 The comparable rise in total income going to the top decile in the US has been from 34% in the 1970s to 48% in 2010. *Ibid.*

54 For Britain the figures are: approximately 28% (of total income going to the top decile) in the 1970s, rising rapidly to around 42% in 2010. Figure 9.7., *ibid.*

in Europe. As we know from cognitive and behavioural science, pervasive insecurity is at least as, if not more, problematic than rising inequality.⁵⁵ Moreover, we know that rising insecurity is specifically correlated with a turn towards tribal thinking and towards stronger in-group/out-group differentiation,⁵⁶ rendering it highly conducive to far-right narratives and patterns of argumentation.

To conclude the first point, the rise in economic insecurity, proxied here by falling real earnings and high unemployment⁵⁷ is likely a key driver of the rise of the far-right in Europe over the last decade; both at the micro level, through triggering stronger in-group/out-group thinking among the victims of insecurity, and at the macro-level, through partly discrediting the received liberal economic narrative of progress through market competition.

Second, a comparison with the two leading Anglophone economies, the US and the UK, shows that macroeconomic policy mistakes were made in the Eurozone, aggravating the impact of the economic crisis especially in already-weaker member states. The unemployment chart above paints a clear picture, with a remarkable ‘second hump’ visible in the Eurozone’s trajectory precisely at the moment where British and American figures plateau and then begin to decline. In fact Eurozone unemployment had not only (briefly) plateaued in 2010-2011, but was beginning to fall, until a second recession and a further increase in unemployment struck. The comparison with the UK and the US, where unemployment continued to fall steadily in the same period (see chart 2), suggests that policy differences rather than global economic conditions were responsible for this

55 E.g. Martikainen and Valkonen (1996; “Excess mortality of unemployed men and women during a period of rapidly increasing unemployment,” *The Lancet* (348)9032: 909-912), finding higher mortality rates among the unemployed in Finland; or Brenner, Petterson, Levi, and Arnetz (1988. “Stress reactions in relation to threat of job loss and actual unemployment: Physiological, psychological, and economic effects of job loss and unemployment” Report No. 210) [In Swedish]. Stockholm, Sweden: Karolinska Institute, Department of Stress Research.) finding that unemployment is linked to excess drinking, smoking, lack of exercise, and a sedentary lifestyle; fear of unemployment is also linked to increased cholesterol levels in the same study.

56 For an extreme version of this effect, using increased salience of death as a trigger of insecurity, see Henry, Bartholow, and Arndt (2010, “Death on the brain: Effects of mortality salience on the neural correlates of ingroup and outgroup categorization,” in *Social Cognitive and Affective Neuroscience* 5:77-87). However, it should also be noted that the insecurity-tribalism relationship is two-directional. Belonging to a stronger, more cohesive group reduces the impact of stress on the individual and improves coping mechanisms (Haslam and Reicher 2006, “Stressing the Group: Social Identity and the Unfolding Dynamics of Responses to Stress,” in *Journal of Applied Psychology* 91 (5)).

57 Further drivers of rising insecurity that have not been analysed here include the flexibilisation of work (as measured through the growth of ‘non-standard’ employment as well as average tenure/duration of jobs), and the extent to which social support and unemployment insurance is conditional instead of unconditional (this can be measured through analyses of particular labour market reforms), both of which make income streams less reliable.

second recession and its associated rise in unemployment.

This hypothesis is further supported by an analysis of government borrowing: while the UK and the US ran larger deficits throughout the entirety of the crisis, the most noticeable difference (see chart 3 below) was visible in 2009-II: where the US and the UK permitted deficits to rise to 10% of GDP and more, injecting sufficient demand to stabilise and then quickly reduce unemployment, the Eurozone made a hard cut at just above 6% of GDP in 2009 and 2010, and then moved to reduce borrowing to around 4% of GDP in 2011. In other words, compared to the UK, the Eurozone was around 4% of GDP more conservative in the crucial years 2009, 2010 and 2011, while compared to the US it was around 5% of GDP more conservative.

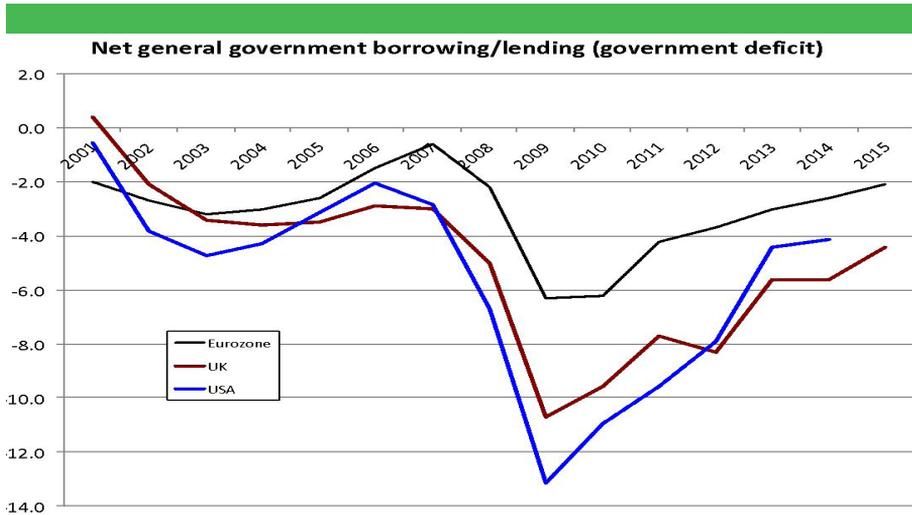


Chart 5: Larger stimuli were run in the US and the UK, peaking at more than 10% of GDP, than in the Eurozone, where they were capped at just above 6% of GDP. Source: author, based on Eurostat data, series "Government deficit/surplus, debt and associated data," code 'gov_1odd_edpt1'; and Federal Reserve Bank of St Louis data, 'General government net lending/borrowing for United States,' code 'GGNLBAUSA188N'

Summed up, the Eurozone ran half as large a stimulus as the US and the UK. While other causes certainly played a role, this significant difference in fiscal stance goes a long way towards explaining the dramatically higher levels of unemployment experienced in the Eurozone compared to the UK and the US.

Moving from fiscal to monetary policy, an analysis of government borrowing costs shows that, when the Bank of England and the Federal Reserve conducted Quantitative Easing (December 2008/March 2009 to December 2013) the difference

between Eurozone government borrowing costs and UK/US government borrowing costs shot up from a difference that had been hovering between zero and negative 1% (negative numbers signaling that Eurozone governments were borrowing cheaper than the UK/US government) to more than two percentage points.⁵⁸ While the classic explanation for this difference in borrowing costs is that they merely reflect market perceptions of risk differential, this explanation ceases to hold when central banks enter the market for sovereign debt in force, as they have done since 2009. By purchasing government bonds, thereby driving up prices (which, in the case of bonds, is the equivalent of driving down the interest rate), central banks are capable of reducing borrowing costs—a policy that was actively pursued in the US and the UK from 2009 on, but eschewed in the Eurozone until 2015. In this context it is notable that the European Central Bank, unlike the Bank of England or the Federal Reserve System, has an asymmetric inflation target of ‘close to, but below, 2 per cent’ (unlike the 2 per cent target of the Bank of England and the Federal Reserve). This gives it a more conservative stance regarding inflation, which arguably contributed to the delay in Eurozone monetary stimulus.

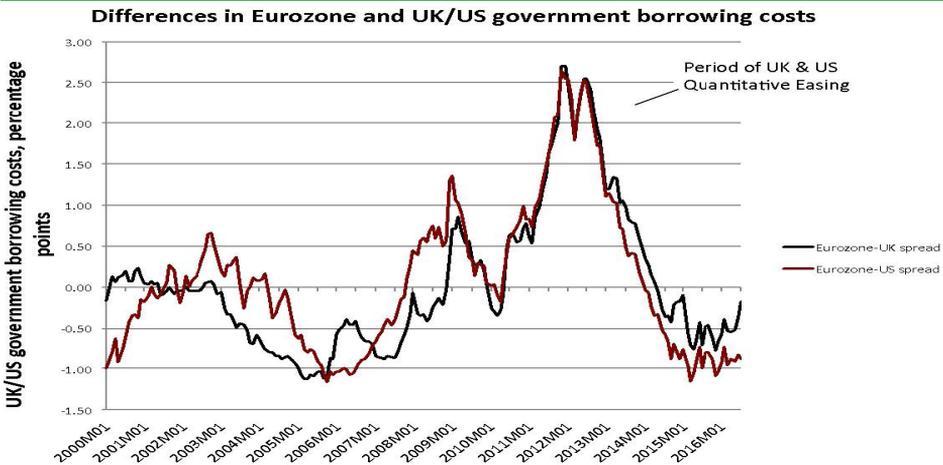


Chart 6: The difference between Eurozone and UK/US borrowing costs increased dramatically when Quantitative Easing was done in the latter, but not the former. source: author, based on Eurostat data, series ‘EMU convergence criterion bond yields,’ code ‘irt_lt_mcbym_m’; and Federal Reserve Bank of St Louis data, series ‘10-Year Treasury Constant Maturity Rate,’ code ‘GS10’

⁵⁸ A two percentage-point spread means that when the US is borrowing at 1%, for example, the average Eurozone government (which includes Germany) would be borrowing at 3%.

Summing up the second point then, relative to the US and the UK, the Eurozone deliberately ran a tighter monetary and fiscal policy in the wake of the crisis. Whereas unemployment plateaued and then started to fall in both the US and the UK from the beginning of 2010 on, in the Eurozone it plateaued and then started to rise again at exactly the same time. In hindsight, Eurozone fiscal tightening was started too early, while further monetary loosening (quantitative easing, on top of cutting interest rates) was introduced too late.⁵⁹ The implementation of austerity without accompanying monetary easing therefore appears highly likely responsible for the diverging macroeconomic fortunes of the Eurozone and the UK and the US. Through directly contributing to higher-than-necessary unemployment rates, these policy mistakes therefore helped to feed the far-right narrative of out-of-touch elites incapable of providing economic security to its citizens.

Finally, and most significantly, the structure of economic policy making in Europe was (and is) such that, on the one hand, international resentment was likely to arise *even in the absence of clear policy mistakes*, while on the other it is such that macro-economic mistakes were (and are) *more likely to actually* be made in Europe, particularly within the Eurozone.

To see how the structure of economic policy making can lead to resentment between nations, even if that policy is not obviously flawed, consider the following example: when conducted within a single state, for example in the UK, a proposal to bail out a particular bank is likely to lead to a vigorous debate. This debate in turn is likely to be framed around ‘citizens versus banks’, or perhaps ‘Labour versus Tories.’ In the US, the framing would be very similar, though the iconic phrase tends to be ‘Main Street versus Wall Street.’ In the Eurozone context, however, policies around bank bailouts have quickly become framed as national issues. It would have sounded absurd if the UK policy debate about what to do with Northern Rock in 2007 had been conducted in a ‘Newcastle-upon-Tyne (and the North in general) versus London (and the South-East in general)’ framing. Yet the coexistence of a monetary union without an economic government at the same level creates very strong incentives for precisely analogue cases to emerge within the Eurozone. Hence, even where a particular policy turns out to be the right one (as the bailout of Northern Rock for example surely was), in the

⁵⁹ For comparison, while the US began quantitative easing between December 2008 and March 2009, and the UK in March 2009, the ECB did not begin its quantitative easing programme until March 2015.

context of the Eurozone this is likely to lead to inter-national resentment.

A second mechanism in which even policies that are optimal at the Eurozone or EU level lead to resentment, particularly vis-à-vis Brussels, is the classic ‘success travels to the capitals, trouble stays in Brussels’ mechanism. As long as economic policy is made through negotiations between national governments and behind closed doors, it is easy for national governments to claim to be the father of every success, but the sore victim of every failure; to be directly and solely responsible whenever a European policy brings distributional benefits to one’s own country, but to have been powerless and innocent whenever another policy brings distributional disadvantages. At the time of writing, unlike virtually any other upper (or indeed lower) house in a Western democracy, the European Council does not produce a public record to make these kinds of statements falsifiable. Moreover, even if there were a public record, the process of bargaining is such that some parties can successfully hide their positions (e.g. because it is already a majority position, or because there already is a powerful and outspoken supporter), only revealing their cards so to speak in case of success, keeping them hidden in case of failure. This makes asymmetric responsibility taking very easy, with the entirely predictable result of continually stoking resentment against Brussels.

Further, economic policy nearly always creates winners and losers. If the losers do not feel like they have a seat at the table and a hand in policy creation—the experience of Greece since the Troika first arrived in Athens in May 2010—it has two dangerous effects: first, the ‘losers’ feel resentment because they experience whatever policy changes are agreed on as an imposition—to a large extent independently of whether these policy changes are good or bad in the long run. Second, the ‘winners’ will feel resentment because the ‘losers,’ driven by their own sense of non-ownership, understandably seek to sabotage or at least delay the ‘agreed-on’ reforms and hence have to be forced every step of the way. Policies that are debated and voted on by an elected legislature are better placed to avoid these issues, because a public, deliberative, and representative process generates legitimacy that simply cannot be generated through a closed-doors, transactional approach.

Lastly, there are two mechanisms through which the structure of economic policy-making increases the likelihood of the kinds of economic policy mistakes that were made in 2009,

2010, and 2011: firstly, as in any grouping of people or organizations, the interests of the parts are not the same as the interests of the whole. When it comes to fiscal policy-making, there is no institution that represents the interests of the whole Eurozone, nor one that represents the interests of the European Union as a whole. This area, unlike monetary policy, is reserved for member states, albeit with a degree of oversight provided by the European Commission (in particular via the European Semester). Hence what we are left with is a process of bargaining between a set of individual interests (the German government bargains for German interests, the Spanish government for Spanish interests, and so on). Now, it is by no means necessary that this process of bargaining between governments that represent partial interests will generate an outcome in the interest of the whole.

Secondly, the decentralized nature of not just fiscal policy but also of much of product market regulation, labor market rules, and welfare policy, prevents coherent bargaining across these different areas. The downside of this once again became obvious in the immediate aftermath of the 2008 Financial Crisis: a grand bargain of structural reforms in periphery economies together with credible promises of future fiscal restraint in exchange for a stronger stimulus (either through fiscal expenditure in core economies or through stronger and earlier monetary stimulus, in particular via direct purchases of the affected government bonds) would have been an obvious solution to the situation in which the Eurozone has been since 2009. But due to a lack of a supra-national economic government that could reliably implement this grand bargain, this bargain has been unavailable, leading to an acrimonious reform process in unfavorable macroeconomic conditions. Thus, because decentralized economic policy making makes the *implementation* of grand bargains of this form challenging (because when push comes to shove, there is no higher power that can ensure that all parties stick to the agreement, other than macroeconomically counterproductive withdrawal of funding), it effectively takes these options off the negotiating table.

Hence the current structure of economic policy making in the EU is likely to produce flawed outcomes not just because the interests of the whole may diverge from the interests of any combinations of its parts (i.e. negotiations are unlikely to settle on the best available policy), but also because the decentralized nature of fiscal policy, parts of product market regulation, labour market rules, and welfare policy takes certain policy options off

the table (and hence Pareto superior policy options may not even be on the bargaining table in the first place).

To recapitulate this third point, the structure of economic policy making in Europe is such that, on the one hand, inter-national resentment is likely to arise *even in the absence of clear policy mistakes*, while on the other hand it is such that macro-economic mistakes are *more likely* to actually be made in Europe, particularly within the Eurozone.

In conclusion then, the combination of these three factors—rising economic insecurity, exacerbated by particular macroeconomic policy mistakes, and compounded by an economic policy making structure not fit for purpose—created the pervasive impression that European economic policy is unresponsive to the needs of its citizens. While the situation is considerably more complicated than a simple ‘economics-to-politics’ correlation—the rise of the far-right is by no means restricted to areas with below-average economic outcomes, nor have all areas with economic difficulties veered right—the justified emergence of the narrative of economic failure has created highly fertile ground for the far-right to mount its challenge. In a time of growing economic insecurity, policy mistakes by established actors, and an economic policy debate that pits countries against each other and against Brussels, nationalist, protectionist, and economic-security oriented policy proposals have understandably gained much ground—and the far-right with them.

The rise of the far-right has been driven by social and economic insecurity. In both areas, they preach a simplistic message of narrowly defined nationalism. They constantly emphasize the threat represented by outside groups, whether they be outside economies, EU regulations, or Muslims. Their message has strong appeal in a time when EU policies have failed in a number of areas to proactively mitigate social and economic security. But the policies advocated by the far-right do not address the root causes of the problem and are unlikely to have positive effects. Indeed, they tend to worsen the problem.

5. THE FAR-RIGHT AND FOREIGN POLICY: RUSSIA’S CHALLENGE TO EU LEGITIMACY

Russian soft power is rising “among European parties and countries that feel themselves victims of the European Union ‘technocracy,’ and that look for new allies to denounce the ‘mainstream’ and its austerity policy, and

call on the periphery to resist the 'system.'"⁶⁰

Russia has forged strong links with far-right movements across Europe in its drive to undermine the current world order backed by the US and EU. This relationship represents a serious challenge to the legitimacy of the EU. In this section we look at 3 examples of EU far-right parties that demonstrate these themes. We also look at the Ukrainian far-right since the conflict there is largely an extension of Russia's attempts to undermine the EU and NATO.

There are two related reasons for Russia's close ties with the EU's far-right – far-right parties admire Putin's brand of authoritarian nationalism and their ideologically informed interests are aligned. Far-right politicians perceive Putin's Russia as a strategic ally in their quest to dismantle the EU, weaken NATO, and reshape their societies in an authoritarian nationalist mold. They portray the EU as a technocracy that does not serve national interests, instead serving the interests of the United States. In addition, far-right parties across Europe are attracted by Putin's ultra-conservative and semi-authoritarian form of governance. For them, Russia is acting as a bulwark of traditional values against their decay in the West. The far-right generally advocates turning away from the West, building stronger ties with Russia, and supporting Russian foreign policy.

The Front National and Russia

"Concerning the Ukraine, [Europeans] act like servants of the Americans."
-Jean Marie Le Pen⁶¹

The Front National (FN) and Russia have formed a very close relationship rooted in a strong historic ideological connection and a mutual alignment of interests. That relationship has resulted in political support for Russian policy and material support for the FN. The implications for the EU are significant since the FN is the most influential far-right party.

France's far-right and Russia share an especially strong relationship. As one leading academic put it, the main reason Russian nationalism has a large influence in France is "the old fascination of free French radical right" because Russia "clings to values that seem to be losing ground in the rapidly changing, some say decaying, Western Europe: a strong ruler and a strong state, nationalism and patriotism, the perpetuation of the idea

60 Laruelle, Marlene ed. *Eurasianism and the European far-right: Reshaping the Europe–Russia Relationship*, London: Lexington Books, 2015: viii. Print.

61 Jean Marie Le Pen's Twitter. 8 Feb. 2015

of Empire... All shades of the French radical right believe that Russia, as the last beacon and stronghold of traditional values, has a mission to oppose the decaying religions and societies of the West and regenerate Europe through its influence and model.”⁶² The FN and the current Russian administration view the EU and by extension the US as threats to these traditional values. At a recent FN gathering, a member of Russian President Vladimir Putin’s political party called the EU a “spineless lackey of the United States.” Thus, the FN view Russian style authoritarian nationalism as the last bulwark of traditional values under threat from the EU and the US.

That relationship has been especially active recently. There is strong evidence the FN has received financial assistance from the Russian government. There is no dispute that the FN received a 9 million euro loan from a Russian bank with very close ties to Putin.⁶³ One FN official said they will get another 31 million, although Marie Le Pen (the leader) refuted this. Russian hackers unearthed SMS messages that show a strong link between the loan and the FN’s support of Russian policy in Ukraine.⁶⁴ Russia has even gone so far as to buy the Christmas tree that stood in front of Notre Dame this last December which is typically funded by local businesses.⁶⁵

The foreign policy stance of the FN is very supportive of Russian interests. The Front National thinks that the new Ukrainian government formed in 2014 is a US vassal. They blame it for sparking the conflict in Eastern Ukraine. They even go so far as to say the US was driven by its Polish and Ukrainian minorities to take control of Ukraine politically, push Russia out, and completely avoid compromise with Russia.⁶⁶

Hungary’s far-right and Russia

“While Eurosceptic or outright rejectionist language towards the EU has grown extensively throughout Europe since the 2008 crisis, it is only in Hungary that the conservative right is presenting geopolitical alternatives to Europe to the public.”⁶⁷ That alternative is Russia.

62 Laruelle, Marlene ed. Eurasianism and the European far-right: Reshaping the Europe–Russia Relationship. London: Lexington Books, 2015: 80. Print.

63 Beardsley, Eleanor and Flintoff, Corey. “Europe’s far-right And Putin Get Cozy, With Benefits For Both.” National Public Radio. 26 Dec. 2014. Web. 27 Feb. 2016

64 “Financement du FN : des hackers russes dévoilent des échanges au Kremlin.” Le Monde. 2 Apr. 2015. Web. 27 Feb. 2016

65 Williamson, Lucy, “Russia’s French Christmas tree diplomacy.” British Broadcasting Corp. 14 Dec. 2014. Web. 27 Feb. 2016

66 “L’Ukraine de l’Ouest désormais « ouvertement » vassalisée par Washington.” Front Nationale. 5 Dec. 2014. Web. 27 Feb. 2016.

67 Laruelle, Marlene ed. Eurasianism and the European far-right: Reshaping the Europe–Russia Relationship,

Nowhere has the far-right had more influence over foreign policy than in Hungary. Jobbik, Hungary's most influential far-right movement and third largest party,⁶⁸ has strong connections with the Kremlin. It was able to gain substantial ground in Hungary by promoting an "old" right authoritarian nationalist message. They are openly anti-semitic and criticized EU austerity measures implemented during the last few years. In addition, Jobbik is promoting nationalist economic policies externally backed by Russia.⁶⁹ As a result of Jobbik's influence, Hungary's center-right government has made a strong pivot towards Russia and away from the EU.

Hungary's turn to Russia started in November 2010, when the center-right Prime Minister visited Russia for the first time.⁷⁰ In May 2013, right-wing Russian nationalists close to the Kremlin invited the president of Jobbik party, Gabor Vona, to also visit Russia. On the Jobbik website, the visit is described as a major achievement which strengthened ties among Russia and Jobbik. In addition, there have been rumors of Russian financial support for Jobbik.⁷¹

Russian influence also extends to paramilitary organizations to the right of Hungarian Jobbik.⁷² "These organizations and their organs may become dangerous instruments and may present political and national security risks even though the support for such efforts is marginal."⁷³ Thus, in order to undermine the EU, Russia is also weakening liberal democracy in Hungary.

Jobbik has led a significant foreign policy shift towards Russia. It shifted the center-right government to the right resulting in a major nuclear deal with Russia.⁷⁴ Currently Russia plans on lending Hungarian government ten billion euros to build two new reactors at its Paks nuclear plant. This deal results in Hungary becoming more dependent on Russia for energy. The president of Jobbik party wants to go even further and join Russia's proposed Eurasian Union. If Jobbik continues to garner influence it can substantially undermine EU and NATO legitima-

London: Lexington Books, 2015: 186. Print.

68 Orenstein, Mitchell A. "Putin's Western Allies." *Foreign Affairs*. 25 Mar. 2014. Web. 10 Feb. 2016.

69 Beitane, Anna. "Examining the Kremlin's and Far-Right Parties Cooperation: Should the EU be Worried?" *Latvian Institute for International Affairs*. 2015. Web. 10 Feb. 2016.

70 Hegedus, Dániel. "The Kremlin's Influence in Hungary: Are Russian Vested Interests Wearing Hungarian National Colors?" *DGAPkompakt*. Feb 2015. Web. 7 Feb, 2016.

71 *Ibid*

72 Krekó, Péter. "'I am Eurasian' – The Kremlin connections of the Hungarian far-right." *Heinrich Boell Stiftung*. May 5. 2015. Web. 8 Feb. 2016.

73 *Ibid*

74 *Ibid*

cy.

Russia and Greece's Golden Dawn

The Greek Golden Dawn party, also known as Chrysi Avgi, advocates for a more aggressive and assertive foreign policy and for a shift from “American - Zionism” towards Russia. The party is one of the strongest “old” far-right parties. Golden Dawn has gained significant influence despite associations with violence, criminality, and neo-Nazism. In the 2012 election attracted approximately seven per cent of the vote.

Golden Dawn has cultivated strong links to Russia. In March of 2015 it served as one of the participants of the International Russian Conservative Forum which was held in St. Petersburg.⁷⁵ In addition, it is known that Golden Dawn has a strong relationship with Alexander Dugin - a Kremlin adviser and one of the most important intellectual voices behind Russian nationalism. In his message, Dugin “expressed support for Golden Dawn’s geopolitical positions and requested to open a line of communication between Golden Dawn and his think tank in Moscow.”⁷⁶ The rapprochement stems largely from distaste for the EU. As one of the foremost academic observers of European far-right notes, “in a climate of mutual acrimony while Greece attempts to extend its \$172 billion rescue program with foreign creditors, especially German, the prospect of getting support from Russia as a bulwark against the Western ‘Atlanticist’ powers beckons appealingly for a Greece in Crisis.”⁷⁷

Golden Dawn supports Russian policy. It opposed sanctions against Russia and praised Russia’s efforts to undermine American and EU hegemony. It is very clear that Golden Dawn perceives Russia as its “natural ally” in the struggle against American imperialism. Russian support of such an openly illiberal “old” far-right party represents a significant challenge to the legitimacy of the EU and the whole current world order.

Ukraine’s far-right and Russia

“Far-right parties pose a threat to established democratic societies, but it may be assumed that the radical right poses a greater threat to developing democracies, such as Ukraine.”⁷⁸ The physical security of the Ukrainian

⁷⁵ Gais, Hannah. “Greece’s Nazi Problem Continues”. medium.com. Mar 26. 2015. Web. Feb 7. 2016.

⁷⁶ Orenstein, Michael. “Putin’s Western Allies”. foreignaffairs.com. Mar. 24. 2014. Web. Feb 8. 2016.

⁷⁷ Marlene Laruelle, ed., Eurasianism and the European far-right: Reshaping the Europe–Russia Relationship, (London: Lexington Books: 2015), viii

⁷⁸ Anton Shekhovtsov. “From Para-Militarism to Radical Right-Wing Populism: The Rise of the Ukrainian Far-Right Party Svoboda.” In Ruth Wodak, Brigitte Mral, Majid Khosravini (eds). Right Wing Populism in Europe: Politics and Discourse. Bloomsbury Academic, 2013: 250

state is under threat.

The war Ukraine has strengthened the country's far-right movement and led to serious instability right on Europe's doorstep. Russia is intervening in the Ukraine's domestic affairs in order to weaken a government that was set on turning the Ukraine towards the West. Russia and many European far-right parties view the Ukrainian government as vassals of the West who want to unfairly bring Ukraine closer to the EU and NATO. As a result of Russian intervention and the weakness of the Ukrainian establishment, the Ukrainian far-right has influence that far outstrips their democratic support. What started as neo-nazi street gangs have grown into some of the country's most effective fighting forces against Russia and further into a major political force.

As with other countries, their actual popular support is low. The most mainstream far-right party, Svoboda, has 6 seats in a 450 seat parliament. There are a smattering of other parties that originate from far-right militias fighting Russia. The Right Sector has been involved significantly in combat but holds only one seat in parliament, having garnered 1.8% of the vote.

Insecurity resulting from a lack of effective governance and Russian intervention have driven far-right influence. A corrupt Ukrainian military created a security vacuum into which far-right parties could rise. In addition, the far-right has been strengthened by the corruption of the Ukrainian state. Many Ukrainians are still seething with anger over the current government's inability to effect significant change.⁷⁹ In addition, Russian interference in Eastern Ukraine has led to disastrous military defeats for Ukraine. The resulting instability means the far-right continues to challenge the government and resist control. Their leaders have made overt calls for violent revolt against the government. They even took the step of establishing their own military command structure independent of the government.⁸⁰ Again, we see a serious challenge by the far-right to liberal democracy partially as a result of Russian meddling.

However, Ukraine also offers an example of how far-right parties lose influence. They have overplayed their hand and tried to usurp too much power. As a result, they have become isolated and weakened. Recently, governmental authorities have cracked down on them successfully. Their opposition to the cease-fire

79 Golinkin, Lev. "Winter Is Coming. And So Is Ukraine's far-right." Foreign Policy. The Foreign Policy Group. 8 Oct. 2015. Web. 26 Feb. 2016

80 Golinkin, Lev. "Ukraine's far-right menace." Politico. Politico SPRL. 1 Sep. 2015. Web. 26 Feb. 2016

also appears to be isolating them more from the mainstream.⁸¹

6. POLICY RECOMMENDATIONS

The rise of the far-right, a reflection of integral fears of society and the failure of the political establishment to solve the perceived problems, can be stopped by addressing the fears in society. The far-right as an expression of fear (and discontent) in society is further exemplified by the significant national differences of far-right political parties. They advocate a return to authoritarian nationalism. In order to counter the far-right narrative, Europe must adopt a proactive vision and narrative that confronts head on the problems highlighted above in a way that furthers integration while honoring national identities.

As discussed in section 4.1, the lack of a coherent European policy regarding migration, and the ability of the far-right parties to play on the European population's insecurity by enabling fear and xenophobia to cloud the picture of any benefits that could come of the influx of migrants are two key social problems at play here. Thus, the time has come for Europe to develop a deliberate policy around this issue to tackle the challenges posed by both refugees and migration. In order to recapture the narrative from the far right the EU needs a policy that can manage Europe's open borders. Refugees and migrants need to be integrated into European societies in a deliberate way. At the same time, the new policy must recognize Europe's role as a global citizen. If Europe shuts itself off, it will lose much of its ability to influence the world scene and further some the key values it stands for such as human rights and dignity. Finally, a policy must honor European national identities. One that does not safeguard national culture and identity will encourage the sense of identity threat that feeds into the far-right's narrative. If it adopts a conscious method of integration, it can safeguard national identities, promote European ideals among citizens from across the world, strengthen national societies by diversifying them, and serve as a role model for the rest of the world.

In fact, integration improves security. A policy that integrates immigrant social groups into the society reduces the root causes of terrorism. David Kilcullen, one of the foremost experts in counter-insurgency theory, notes that European Islamic terrorist groups...

feed on the rapid and, in some cases, destabilizing societal

⁸¹ Golinkin, "Ukraine's far-right menace"

changes of the past several decades....The aim should be not to arrest or kill adversaries but to co-opt them—not to destroy the enemy but to win him over...Most members of opposition groups can be co-opted or persuaded to reconcile under some circumstances, [but] some extremist operatives are beyond co-option and must be eliminated (through arrest and detention by police and security services). But this must occur in a discriminating and carefully targeted manner, to minimize the rejection response, limit the damage to broader society, and forestall the creation of further grievances that extremists can exploit.⁸²

Kilcullen is arguing that terrorism in Europe is fed by social instability. A policy that co opts disenfranchised groups and integrates them will undermine support for terrorist. The “rejection response” he refers to is the response a social group has against poorly targeted counterterrorism policies implemented by a government. The policies advocated by a far-right are very poorly targeted, they are targeted against an entire religious or ethnic group. The rejection response from those policies will only make counter-terrorism efforts harder. By contrast, policies that integrate Muslim social groups and only target the very few directly involved in terrorism are more effective.

As the economic analysis above made clear, rising economic insecurity, particular macroeconomic policy mistakes, and an economic policy-making structure not fit for purpose created the pervasive impression that European economic policy is unresponsive to the needs of its citizens. This in turn created a fertile ground for far-right parties issuing a renewed call for national sovereignty, reassertion of national level economic policy, and a weaker EU. However, the problem largely stems from a lack of coherent and integrated economic policy; and not from too much integration in this area. The European economy has become strongly integrated without having developed sufficient common policy instruments. Like a boat sitting in the middle of a river, this situation was unproblematic during good times; but when a flash flood struck, the limitations of this arrangement became amply obvious. While progress has been made in overcoming these limitations--in particular in the area of joint banking supervision--a shared fiscal capacity is still lacking, and monetary policy still retains an overly conservative stance, driven in part by an unnecessarily asymmetric mandate. We therefore recommend that the European Union assume additional fiscal

82 Kilcullen, David. *The Accidental Guerilla*. Oxford: Oxford University Press, 2009: 259. Print.

responsibility, submit this fiscal responsibility to democratic oversight, and revise the inflation target of the European central bank to correct these issues.

However, fiscal policy must be overseen by a genuine democratic legislative institution. Whether this be formed -- à la Piketty--through creating a chamber composed of national deputies, or through electing a Eurozone fiscal parliament, reforms of these kind would decrease concerns over giving sovereign powers to otherwise opaque supra-national institutions. This is a vital component of any attempt to recapture the narrative of the European project and reduce support for the authoritarian nationalist policies of the far-right. A sufficiently legitimate political institution overseeing Eurozone fiscal policy would also permit more active macroeconomic demand management, a crucial component for keeping unemployment under control in crisis situations. The economic narrative could then become one of regaining control over Eurozone economic performance by letting go of limited national freedoms in exchange for stronger shared governance. These steps would strengthen economic prosperity, security, and ultimately freedom.

The foreign policy section made clear the dual and contradictory nature of the Russian narrative. They have tried to exaggerate the importance of the far-right and claimed they are intervening in the Ukraine against fascist forces. At the same time, they are supporting similar movements in other European countries. The contradiction presents an opportunity for the EU. We have seen how Russian backed far-right parties could do serious damage to the legitimacy of the EU if they gain more strength. We have also seen how Russian interference has created serious instability right at Europe's doorstep and resulted in an outsized influence for the Ukrainian far-right. But this presents a strong opportunity for the EU to redefine itself in opposition to Russian authoritarian nationalism.

Overall, the EU needs a coherent narrative. As discussed above, there are multiple reasons why the far-right and Russia's narrative is vulnerable. First, as is evident in Ukraine, Russia's narrative is blatantly inconsistent. Second, we have seen how economic integration will create more stability, not the national based policies of the far-right. Third, the far-right's social policies will only weaken European identity by isolating it from the global stage and hurting counter-terrorism efforts.

Thus, the EU should promulgate a narrative with these elements:

“Russia and the far-right are correct, we are an institution designed to integrate Europe under a banner of liberal and social values. This guarantees our continued economic and social strength. We have seen what Europe looks like when the authoritarian nationalism promulgated by Russia and the far-right dominates. The end result will be economic and social disaster, irrelevance on the global stage, and possibly foreign domination. We are professional institutions that ensure European social and modern values can thrive in an age of increasing interconnectedness. We ensure European national identities thrive in the 21st century by nesting them within a larger trans-national sense of identity, just as strong regional identities within states are nested within national identities. As the far-right points out, our national identities are sacred. But they must be nested to solve the problems of interconnected world and ensure Europe’s prosperity, security, and global influence.”

This narrative highlights what the EU is, and what it is not. By emphasizing Russia’s links to the far-right it isolates the forces of authoritarian nationalism by portraying them as under outside influence. As shown above, there is ample evidence to back up this claim. This narrative frames the EU as an institution ensuring European national identities continue to thrive by nesting into a larger structure. Further integration, when the time is right, can only serve this goal.

7. CONCLUSION

The EU has an excellent opportunity to recapture a narrative that mobilizes strong political support. We have seen that Russia and the far-right are challenging the EU with a contradictory narrative rooted in unsustainable authoritarian nationalism. The challenge for EU policy is to actually live up to this narrative. Failing to do so will result in increased strength for European far-right parties. Russia will be able to undermine the EU and strengthen its own position. Europe will be unable to cope with the interconnected social and economic problems it is facing. European integration will be stalled and authoritarian nationalist movements will gain more support.

The authors are members of European Horizons, a US-based, non-partisan think-tank devoted to exploring the meaning of European identity, modernizing and reforming the concept of the social market economy, advancing the cause of European integration, and deepening transatlantic relations.

Immigration and Integration

5. 1. A Collective Response to Terrorism: How the Kadi Case restores Balance for the International Society

SUBMITTED BY

Hans Rusinek

ABSTRACT

This paper incorporates the Kadi judgment of the European Court of Justice (ECJ) into the English School framework. By doing so it tries to answer how the community of states deals with normative tensions raised by counterterrorism efforts and effectively how different legal orders interact. The greatest danger lurks in the background - the threat of terrorism can lead agents to unilateral actions which neglect the collective norms of international society and hence weaken it profoundly. However, a successful response to global terrorism must be collective. To analyze these tensions and the ECJ's way out recent English School concepts are brought together with insights from Global Constitutionalism. The paper argues that in the Kadi case the ECJ is outbalancing the normative tensions created by a UN resolution (1267) that has had the potential to disrupt the cohesion of an international society.

1. INTRODUCTION

Building a trap for the state provoking it to show its “true, fascist face”¹ is how the Red Army Faction (RAF) described their terrorism strategy. Following this logic terrorism has a dual impact: a direct impact by causing destruction and fear, as well as an indirect one rooted in a possible overreaction of the targeted state. In such an overreaction, the state would discard its values to fight terrorism. Then, according to the RAF, the population would naturally rise against the state.²

The RAFs concept of an *indirect threat* can be transferred into the post-9/11 world of globalized terrorism. Devetak,³ Vincent⁴ and Mendelsohn⁵ argue that in the case of modern transnational terrorism the primary threat to international order may not come from terrorism itself but from the response to it. Here, not only single states but the community of states as a whole is under attack⁶. Terrorism becomes an issue of global governance. The norms, which states could throw overboard when fighting terrorism, are now internationally shared norms and not norms between state and society as in the RAF case. Because of terrorism’s transnational properties states have to act collectively.

An overreaction in the context of globalized terrorism is a violation of these common norms e.g. in the way states use surveillance, detain terrorists or cut their financial flows⁷. If those actions attack a consensus about appropriate behavior in the international community, the cohesion of the community is at risk. Without collective norms the problem of terrorism cannot be addressed collectively and hence not at all, therefore the states triggered by terrorism would harm international order by violating its norms like a caged animal hurts itself in confusion. Successful collective action relies on underlying rules of interaction.

At the heart of this predicament is the balance between the norms of human rights and the need for security (e.g. the ab-

- 1 Aust, S. and Bell, A. (2009) *Baader-Meinhof: The Inside Story of the R.A.F.* (Oxford: Oxford University Press)
- 2 Chancellor Brandt reacted by banning people with “radical views” to work as public servants (incl. education). This isolated the government from major parts of society and traumatized the young generation (Merseburger 2002).
- 3 Devetak, R. (2005) “Violence, Order and Terror.” In Bellamy, A. (ed) *International Society and Its Critics* (Oxford: Oxford University Press) 229-246.
- 4 Vincent, R. J. (1986) *Human Rights and International Relations.* (Cambridge: Cambridge University Press).
- 5 Mendelsohn, B. (2005) “Sovereignty under Attack: The International Society Meets the Al Qaeda Network.” *Review of International Studies* (Vol: 31, no. 1) 45-68.
- 6 Ibid
- 7 Devetak

sence of terrorism). The root of this dilemma is in the question of how we “protect freedom (through security) without denying its essence (by violating human rights)”.⁸

Since norms are constantly debated, a shift as a response to a changing international environment is not a problem per se. Such shifts are an essential mechanism to preserve international cohesion. Rules have to change when the world changes. But during those shifts, it is crucial that the result is still a collective set of norms for all members of the international community. Either an actor betrays the values of the community unilaterally and by that breaks down what renders a group of states a community or the community collectively renegotiates its rules to adjust to external changes while sustaining a normative consensus.

Understanding how the international community is dealing with this indirect threat of self-betrayal through terrorism emerges as a crucial question for international cooperation in a post-9/11 world.

To illuminate this question, this study will investigate the *Kadi* case. This case is a key event visualizing how the international community addresses the illustrated challenges – the UN Security Council identified the Saudi Arabian businessman Yassin Al-Kadi as a supporter of Al-Qaeda and issued sanctions following resolution 1267 (R1267). Al-Kadi opposed this decision in front of the EU courts arguing that the decision was not in compliance with fundamental human rights. The European Court of Justice (ECJ) decided that Mr. Al-Kadi’s rights indeed had been violated.⁹

On the normative level, the *Kadi* case illustrates the profound governance dilemma between human rights and effective security measures.¹⁰ On the institutional level, such a disagreement between the UNSC and the ECJ can already be viewed as a crack in the international community both institutions are meant to manage. But it can also be seen as an institutional rebalancing taking place, where the ECJ and the UNSC dialectically find a common understanding of the human rights security dyad in order to keep norm change a collective change.

The central thesis of this paper is that in the *Kadi* case the ECJ is outbalancing the normative tensions created by a UN

8 Goold, B.J., and Lazarus. L. (2007) “Introduction: Security and Human Rights: The Search for a Language of Reconciliation.” In Goold, B.J., and Lazarus. L.(eds.) Security and Human Right (Oxford: Hart).

9 Lang, A. (2013) “Global Constitutionalism as Middle Ground Ethics.” In Navari, C. (ed) Ethical Reasoning in International Affairs: Arguments from the Middle Ground (Basingstoke: Palgrave Macmillan).

10 Klabbers, J. (2008) “Kadi Justice at the Security Council?” International Organizations Law Review (Vol: 4 no.2) 293-304.

resolution that has the potential to disrupt the cohesion of the international society. In order to do so, it develops an analytical framework built on the English School of International Relations and traces the development of the counterterrorism regime cumulating in *Kadi*. Thereby, this study attempts to offer important insights into the general connection between counterterrorism and the preservation of the international society.

By investigating the *Kadi* case, it tries to answer how the community of states deals with normative tensions brought up by counterterrorism. This empirical question is dovetailed by the theoretical question of how to study it.

By looking at the community of states, its cohesion, and collective norms the term “international society”, a key concept of the English School, suggests itself. Under the theoretical framework of the international society, normative issues are linked to political realities illustrating the fundamental tension between the “ideal and the actual”.¹¹ The dyad of human rights and security expresses this dilemma.

This study will not only show how the English School helps to analyze *Kadi*. Inversely, by looking at counterterrorism it investigates if and how the English School explains a central aspect of our contemporary world. This work has a twofold function by presenting an empirical study preceded by a theoretical discussion. This discussion goes beyond only setting the stage for the case by offering a theoretical review of the international society in a transnationalizing world. Hence, *Kadi* serves as a backdrop for the English School as much as the English School functions as a framework for *Kadi*.

The first chapter introduces the theoretical concepts underpinning the empirical study of a collective reaction to terrorism. Hedley Bull’s approach to the English School is reviewed as a key entrance point leading to the meta-theoretical debate between solidarist and pluralist interpretations. Synthesizing on this, Buzan’s approach serves as the necessary adjustment to create a framework for *Kadi*.

The second chapter outlines the theoretical framework informing the study of the *Kadi* case. It locates terrorism, norm change, and international institutions in this framework.

The third chapter analyzes the *Kadi* case, the history of its origins, and its possible aftermath, by using tools provided by

11 Cochran, M. (2009) “Charting the Ethics of the English School: What ‘Good’ Is There in a Middle-Ground Ethics?” *International Studies Quarterly* (Vol:53, no. 1) 203-25.

the theoretical framework.

The final chapter discusses the results of the case study. It presents the insights gathered on the case, practical and theoretical implications, and the wider debate.

2. METHODOLOGICAL REMARKS

With its three traditions of international system, international society, and world society the English School is necessarily eclectic in its methods¹². This work understands the three traditions as a set of analytical concepts designed to capture the material and social structures that exist simultaneously.¹³

Following Linklater¹⁴ the study of the international system requires positivist approaches. The study of international society, however, needs hermeneutical tools because it is concerned with social conventions for members of the society. Both antithetical approaches are synthesized when it comes to world society, which requires the transformative concepts of critical theory.¹⁵

Since this study applies an international society perspective, it applies hermeneutics. A number of different approaches on how to interpret international conventions are possible.¹⁶ Suganami¹⁷ views these conventions as operative principles with their own agency, and for Jackson¹⁸ they result from a code of conduct between statespersons. Little¹⁹ and Buzan²⁰ focus on larger environments of action as shaping variables. The latter, therefore, apply a structural view on conventions whereas Jackson focuses on agents and Suganami on institutions themselves.²¹

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- 12 Little, R. (2009) "History, Theory and Methodological Pluralism in the English School." In Navari, C. (ed) *Theorising International Society English School Methods*, (Basingstoke: Palgrave Macmillan).
- 13 Buzan, B. (2004) *From International to World Society? English School Theory and the Social Structure of Globalisation*. (Cambridge: Cambridge University Press).
- 14 Linklater, A. (1990) *Beyond Realism and Marxism: Critical Theory and International Relations*. (Basingstoke: Macmillan).
- 15 Ibid
- 16 Navari, C. (2013) "World Society and English School Methods." (Online). *E-International Relations* <http://www.e-ir.info/2013/05/01/world-society-and-english-school-methods/>. (Assessed: 20 August 2015).
- 17 Suganami, H. (2003) "British Institutionalists, or the English School, 20 Years On." *International Relations* (Vol: 17, no. 3).
- 18 Jackson, R.H. (2003) *The Global Covenant: Human Conduct in a World of States*. (Oxford: Oxford University Press).
- 19 Little, R. (2009) "History, Theory and Methodological Pluralism in the English School." In Navari, C. (ed) *Theorising International Society English School Methods*, (Basingstoke: Palgrave Macmillan).
- 20 Buzan, B. (2004) *From International to World Society? English School Theory and the Social Structure of Globalisation*. (Cambridge: Cambridge University Press).
- 21 Navari, C. (2013)

This study mainly follows Buzan and gives structure explanatory preference. The international society reacts to external shocks that neither result from institutions themselves nor from individual statespersons' codes of conduct. The shaping independent variables are structural changes such as the end of the Cold War, the increasingly transnational character of the international society, and the appearance of international terrorism. In other words, codes of conduct and operative principles are results of a changing environment.

Using the schema of comparative and institutional analysis suggested by Little²² for structural analysis, this study observes a timeframe from the early 1990s to the end of the 2000s. This frame can account for the slow structural changes and also attempts to capture the early aftermath of the *Kadi* decision. These changes are expressed in the UNSC's resolutions. Its legal treaties are in its nature at the intersection of the methods Wilson calls legal positivism and aspirational legalism (Wilson 2009). The former looks at what the law is ("hard law") while the latter asks where the law is heading ("soft law").

In conclusion, this study qualitatively analyzes how legislation changes in a defined time frame as an expression of structural changes.

3. AN ENGLISH SCHOOL APPROACH

3.1. INTERNATIONAL SOCIETY, ORDER, AND INSTITUTIONS

A helpful tool to analyze the collective response to terrorism and hence to make sense of *Kadi* is the concept of "international society". Following Bull's opinion,²³ states become conscious of each other and form a society when they have sufficient contact with each other. Conscious of common interests they conceive themselves to be bound by a common set of rules.²⁴

Order can then only be provided collectively by a common set of institutions (i.e. international norms). These norms are e.g. international law, diplomacy, and the balance of power. Order as a "purposive pattern that humans infused with mean-

²² Little, R. (2009)

²³ Bull, H. (2002) *The Anarchical Society: A Study of Order in World Politics*. 3rd ed. (Basingstoke: Palgrave).

²⁴ *Ibid*

ing” stains the goals of the international society²⁵. Jones²⁶ points out that this relationship is tautological; the society creates order and order is essentially a set of goals, which is unique to this society.

Beneath this tautology, there are analytically more substantial sub-goals such as the maintenance of state independence and the regulation of war. These goals lead to the development of common norms called institutions, which are meant to stabilize the goals. Thus Disorder is a state system without common rules, without independent states, and with the occurrence of unregulated warfare. Brown summarizes the international society as a “norm-governed relationship whose members accept that they have at least limited responsibilities towards one another and the society as a whole”.²⁷

The idea of collective order frames the various problems of global governance our world is facing today²⁸ (Weiss 2013). Order can only be achieved collectively through norms (as long as there is no global hegemon), but at the same time, the international society aims to respect the sovereignty of states.²⁹ This is a delicate balance since norms are necessary constraints (what Brown calls “limited responsibilities”). Seen through this lens the collective fight against transnational terrorism is a subgroup of the international society’s struggle for order. Counterterrorism, therefore, catches the inherent dilemma between collective action and individual sovereignty.

Together, these concepts outline a first framework for the study of *Kadi*. Bull offers us a paradigm to connect the political with the normative sphere, and through him, we see the international system as a society based on common norms. Under this paradigm (and in contrast to materialist billiard-ball metaphors) it matters if agents act according to norms or not when they respond to terrorism. The violation of normative principles has a direct effect on the political realm by threatening order. States are sentient; how they assess each other’s actions determines

25 Hurrell, A. (2013) “Probing the Institutional Fabric of World Politics: Hedley Bull’s The Anarchical Society.” In Bliddal, H. et al. *Classics of International Relations: Essays in Criticism and Appreciation* (Abington: Routledge).

26 Jones, R. E. (1981) “The English School of International Relations: A Case for Closure” *Review of International Studies* (Vol: 7, no. 1) 1-13.

27 Brown, C. (2009) *Understanding International Relations*. 4th ed. (Basingstoke: Palgrave Macmillan).

28 Weiss, T. G., and Wilkinson, R (2013) *International Organization and Global Governance* (London: Routledge).

29 Butterfield, H. and Wight, M. (1966) *Diplomatic Investigations: Essays in the Theory of International Politics*. (London: George Allen and Unwin).

future interaction.³⁰ An overreaction to terrorism can be analyzed through the international society framework. Since norms are the fundament of the international society any negligence of normative principles would cause a relative disorder. An overreaction would occur, when some agents deviate from the rules relative to the rest of the international society and by doing this destroy the collective power of rules.

We now have the analytical “boxes” for the study of international society vis-a-vis terrorism. The English School already offers helpful tools that underline the collectiveness of an adequate response to terrorism and carve out the link between norms and politics. The following section, however, reveals two analytical weaknesses of the Bullian approach when applied to the problem of collective counterterrorism.

3.2. EPISTEMOLOGICAL AND ONTOLOGICAL CHALLENGES

Within international society theories, the type and extent of norms have been discussed in the pluralism/solidarism-debate. The predicament is that the deeper the norms are i.e. the more they focus on individual rights, the more they depart from the foundational function of international society serving sovereignty and non-intervention.³¹ Bull’s international society is strictly committed to the aim of sovereignty. Therefore, it includes only norms governing state interaction such as the balance of power, international law, diplomacy, and the recognition of great powers. Here international law is only included as long as it is rooted in the rights of states (i.e. as a positive law by and for states). For Bull, individual rights create more tension between states than they create order.³² Here the international society is essentially about state primacy; the solidarist concept is essentially about cosmopolitanism. Therefore, both are seen as mutually exclusive.

Such expositions are unsatisfactory for our study that includes both human rights and security. In Bull’s pluralist interpretation, an international society is either committed to individual rights or state rights, never both. Solidarism, on the other hand, is blind with regards to sovereignty. The study of *Kadi* requires a theory that takes both into account since terrorism attacks state sovereignty leading to responses that might

³⁰ Buzan, B. (2004) *From International to World Society? English School Theory and the Social Structure of Globalisation*. (Cambridge: Cambridge University Press).

³¹ Bull, H. (2002) *The Anarchical Society : A Study of Order in World Politics*. 3rd ed. (Basingstoke: Palgrave).

³² *Ibid*

violate human rights. This is a problem of epistemology in the broader sense because pluralism cannot gain knowledge about the international society through the concept of human rights. Bull's framework is an important basis but needs to be reinterpreted in this aspect.

In addition to this epistemological problem, Bull's international society also has ontological restrictions – the English School's starting point is the system of states with sovereign states as fundamental units.³³ This poses two problems for our study of the international society and terrorism. First, terrorists are not states. Second, and for this study of counterterrorism even more relevant, the main responding actors (UNSC and ECJ) are also not states. International organizations have become much more than a mere extension of states and they follow state interests on an increasingly elevated level.³⁴ Therefore, Bull's international society theory also has ontological deficits when it only looks at states as relevant agents.

What looked like an ideal theory to study the *Kadi* case and the collective response to terrorism reveals itself as in need of reinterpretation – international society theory in its orthodox Bullian sense is epistemologically underdetermined because it can either look at human rights or sovereignty and is ontologically underdetermined because it is only concerned with the actions of states. For the study of *Kadi*, this approach needs to be customized.

3.3 AMENDING BULL: KADI BETWEEN INTERNATIONAL SOCIETY AND WORLD SOCIETY

Despite the deficits Bull's international society faces, dismissing the English School theory entirely would mean throwing the baby out with the bathwater; the link between the normative and the political realm and the idea of states as a society that needs to be defended collectively are too important for analyzing the effects of terrorism and the difficulties when responding to it.

It is time to look again at the English Schools triad, which goes beyond international society theory. The argument here is that the *Kadi* case is at a boundary zone between international so-

33 Butterfield, H. and Wight, M. (1966) *Diplomatic Investigations: Essays in the Theory of International Politics*. (London: George Allen and Unwin).

34 Andreev, A. (2007) "To What Extent Are International Organizations (IOs) Autonomous Actors in World Politics?" *Opticon* 826 (Vol: 1 No. 2) 23-30.

ciety and world society. The latter is a cosmopolitan community of mankind as envisioned by Immanuel Kant.³⁵ In this boundary zone, the pure concern for state rights has partly given way to individual rights. Simultaneously there are international organizations (IOs) that are not only constraining but also creatively shaping international society. Strong transnational elements in terms of epistemology and ontology need to be imported into our understanding of international society.

The obvious scholar to consult would be Raymond Vincent, Bull's doctoral student. His study of human rights places him exactly at this boundary zone.³⁶ He argues that in extraordinary violations of human rights the principle of non-intervention should be suspended.³⁷ His framework includes states, transnational actors, and individuals. However, despite this Vincent is not of great help. Yassin Al-Kadi was defended on the basis that the UNSC decision harmed his right to a fair hearing. This is not what Vincent meant with "extraordinary violations" – he was concerned with genocides and mass starvation.³⁸ Hence for the *Kadi* case, Vincent would not deviate from Bull ignoring "lesser" human rights violations. Vincent's ontology is also not as satisfying as it seems. By breaking down the boundaries between world society and international society Buzan argues that Vincent's theory is analytically unclear. Vincent does not offer an adjustment, which can be applied specifically to this study.

Vincent serves here as an indicator to point out the required adjustments. A theory for *Kadi* must include lesser human rights and should preserve the analytical distinction between world society and international society. As shown above, the contemporary international society has grown out of the state-centric boxes of Bull's classical international society towards a more solidarist end. But still, at the same time we can see state sovereignty as a powerful element. For a theory combining both poles, we need to depart from Bull and Vincent to another English School major thinker: Barry Buzan.

Buzan fundamentally disagrees with Bull about the relation between solidarism and pluralism. He argues that they are not mutually exclusive but on a spectrum by using the terms of a "thin" and "thick" international society. Buzan points out that

35 Bull, H. (2002) *The Anarchical Society: A Study of Order in World Politics*. 3rd ed. (Basingstoke: Palgrave).

36 Buzan, B. (2004) *From International to World Society? English School Theory and the Social Structure of Globalisation*. (Cambridge: Cambridge University Press).

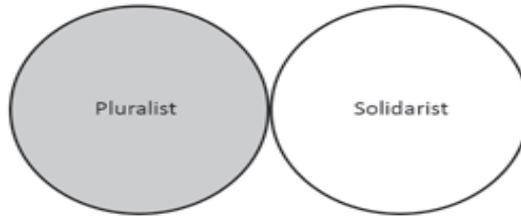
37 Ibid

38 Vincent, R. J. (1986) *Human Rights and International Relations*. (Cambridge: Cambridge University Press).

Bull overlooks a loophole.³⁹ Positive law does not prevent states developing more extensive shared values such as the human rights we are concerned with in *Kadi*. As a result, both conceptions are not exclusive; states can be concerned with human rights without sacrificing sovereignty.

A philosophical conundrum is making this reconciliation possible. Sovereign agents must be able to give up sovereignty if they want to. If they cannot, they will not be sovereign. This happens in two ways. one is that states voluntarily submit themselves to laws concerned with individual rights through the proliferation of an extensive human rights regime. Another way is that states pool their sovereignty through the workings of IOs. In this sense, states gave up parts of their sovereignty by forming solidarist societies in a truly sovereign act. Pluralism and solidarism, therefore, describe degrees of shared norms.⁴⁰

Bull's Understanding: Incommensurability



Buzan's Understanding: Gradualism



Figure A: *Two Understandings of International Society*

In this sense, Buzan reconciles the idea of positive law with human rights; individuals can be subject to human rights as long as the law is derived from the will of states.⁴¹ Buzan interprets Bull as a proto-solidarist. He is thereby ruling out the incommensurability of his theory with human rights and thus creates space for *Kadi* in this framework. Since this cosmopolitan idea of human rights can be derived from state-centric positions, we

³⁹ Buzan, B. (2004) *From International to World Society? English School Theory and the Social Structure of Globalisation*. (Cambridge: Cambridge University Press).

⁴⁰ *Ibid*

⁴¹ *Ibid*

can conclude that *Kadi* is still on the international society side of the boundary region. The tension between human rights and sovereignty and the tension of epistemology is resolved.

The same line of thinking applies to the ontological issue. Moving towards the solidarist end of the spectrum, states that become more internally alike in terms of norms and share a wider set of ideas begin to redistribute sovereignty to semi-external agents like the EUCJ and UNSC.⁴² In this modified Bullian approach, the defenders of order are not just states anymore but IOs tackling issues of global governance.⁴³

Hence, our and *Kadi's* society is increasingly transnational. In this sense, Bull received an improving update taking into account the fact that other sources of order have evolved.⁴⁴

This section has reviewed more inclusive approaches. In order to conceptualize a normative clash of human rights and security within the international society, an international society theory that includes both notions is needed. Vincent's approach was not helpful here because it only looks at extraordinary breaches of human rights and it does not offer the required analytical concepts. Buzan's approach shows that solidarism and pluralism are not mutually exclusive. With this adjustment, the international arena within *Kadi* is adequately theorized as a transnationalizing society with tensions between state and non-state elements. These insights now allow a framework for the study of *Kadi*.

4. A FRAMEWORK FOR *KADI*

Buzan's theory illustrates contemporary international relations, which have shifted away from a purely Westphalian mode, with its main tension between states to a world where transnational and international society overlap and interweave.⁴⁵ Territoriality and supraterritoriality "coexist in complex interrelations".⁴⁶ Transnational elements exist above as well as below the state. The *Kadi* case illustrates both tensions. Above the states, there is the tension between states and international orga-

42 Andreev, A. (2007) "To What Extent Are International Organizations (IOs) Autonomous Actors in World Politics?" *Opticon* 826 (Vol: 1 No. 2) 23-30.

43 Buzan, B. (2004) *From International to World Society? English School Theory and the Social Structure of Globalisation*. (Cambridge: Cambridge University Press).

44 Hurrell, A. (2002) "Foreword to the Third Edition: The Anarchical Society 25 Years On." In Bull, H. *The Anarchical Society: A Study of Order in World Politics*, 3rd ed. (Basingstoke: Palgrave).

45 Buzan, B. (2004) *From International to World Society? English School Theory and the Social Structure of Globalisation*. (Cambridge: Cambridge University Press).

46 Scholte, J.A. (2005) *Globalization: A Critical Introduction*. 2nd ed. (New York: Palgrave Macmillan).

nizations. Below the states, there is the need to defend individual rights against the concern for sovereignty, the fundamental right of states.

Buzan's English School interpretation is an adequate way to think about the contemporary stage of challenged statehood by capturing the simultaneous existence of state and non-state elements operating alongside and through each other, without finding this conceptually problematic.⁴⁷

Further, Buzan characterizes the present world as a modestly cooperative international society in which its pluralist coexistence elements are deep-rooted and stable, whereas its solidarist cooperative ones are shallower and could easier be swept away by changes.⁴⁸ This is a crucial element of the indirect threat of terrorism because an overreaction is a sudden vanishing of cooperative norms.

4.1. LOCATING TERRORISM IN A "TRANSNATIONAL SOCIETY"

This section connects the systemic threat of terrorism with the international society and describes the implications for an adequate response.

The phenomenon of transnational terrorism is also an expression of transnational elements influencing the international society. Bull noted that "internationalized civil violence" is a sign for an emerging single global political system.⁴⁹ This kind of violence is contagious beyond national borders, it has an internationalizing effect when states become embroiled in each other and consequently embroiled with each other, and hence terrorism can lead states to certain actions; they become violent actors in their own right. Building on Bull, Devetak demonstrates terrorism has evolved into a "new terrorism" beginning in 1993 with the first attack on the World Trade Centre, making it a more urgent threat to international society.⁵⁰ "New terrorism" has a greater lethality of attacks, greater technological and operational competence, and the desire to obtain weapons of mass destruction (WMD).

Mendelsohn defines the threat of "new terrorism" as

47 Buzan, B. (2005) "International Political Economy and Globalization." In Bellamy, A. (ed.) *International Society and Its Critics*, (Oxford: Oxford University Press) 115-134.

48 Buzan, B. (2004) *From International to World Society? English School Theory and the Social Structure of Globalisation*. (Cambridge: Cambridge University Press).

49 Bull, H. (1972) "Civil Violence and International Order." *The Adelphi Papers* (Vol: 11, no. 83) 27-36.

50 Devetak, R. (2005) "Violence, Order and Terror." In Bellamy, A. (ed) *International Society and Its Critics* (Oxford: Oxford University Press) 229-246.

systemic because it attacks the international society as a whole.⁵¹ “New terrorists” reject the basic rules of the international society; the sovereignty of states, its monopoly of legitimate force, and any restrictions on the use of force in general.

Since this threat is defying any state boundaries, the response needs to be collective and not only restricted to targeted countries.⁵² The response must include a broad range of subjects to fight terrorism effectively, from counterterrorism finance to the monitoring of cultural and educational institutions.⁵³ As an arena of this global effort, international organizations must assume responsibility to “design a collective response, bridge differences, and coordinate concrete steps”.⁵⁴

In this situation, the UN is the logical candidate because it encompasses all states, contains mechanisms to authorize action, and has a relatively high degree of legitimacy. The UN can also mitigate the risk of a unilateral overreaction by safeguarding the society from any abuse of an overarching hegemon.⁵⁵ However, the question of how abuses by international organizations themselves are prevented, ergo who is watching the watchmen, will be discussed in the case study.

This section has explained that the systemic threat of terrorism calls for a collective response. This response is best achieved in a cooperative effort between international organizations and states. Therefore, it is now necessary to link the primary institutions (i.e. norms) to secondary institutions (i.e. international organizations).

4.2. NORM CHANGE AND INSTITUTIONAL COORDINATION

The English School neglects the study of secondary institutions as the enforcers of primary institutions.⁵⁶ This gap is filled by institutionalists interested in “arrangements, formally or informally organized” seen as “specific institutions...that can be identified as...complexes of rules”.⁵⁷ Their sociological perspec-

51 Mendelsohn, B. (2005) “Sovereignty under Attack: The International Society Meets the Al Qaeda Network.” *Review of International Studies* (Vol: 31, no. 1) 45-68.

52 Ibid

53 Mendelsohn, B. (2009) *Combating Jihadism: American Hegemony and Interstate Cooperation in the War on Terrorism*. (Chicago: The University of Chicago Press).

54 Ibid

55 Ibid

56 Buzan, B. (2005) “International Political Economy and Globalization.” In Bellamy, A. (ed.) *International Society and Its Critics*, (Oxford: Oxford University Press) 115-134.

57 Keohane, R. (1988) “International Institutions: Two Approaches.” *International Studies Quarterly* (Vol: 32 no.4) 379-96.

tive “views international organizations as emerged from prior institutionalized contexts”. Authors of this approach like Kratochwil⁵⁸ and Ruggie⁵⁹ emphasize intersubjective meanings as the foundation of institutional activity. These institutions do not simply influence external variables of cost and utility, they shape preferences and power, and in this sense, they are constitutive of actors.⁶⁰ Further institutions are open for change by reflecting historically distinctive combinations of material circumstances, patterns of social thought, and initiative.⁶¹

In the international society framework “prior institutionalized contexts” can be seen as the primary institutions. “Intersubjective meanings” are the norms surrounding these institutions. The constitutive elements confirm what has been discovered in a previous study of the border between world society and international society –the institutions develop a life of their own.

By linking primary to secondary institutions we can synthesize that the notion of sovereignty is translated into the existence of the UNSC and other regional organizations such as NATO, which act on behalf of legal agreements such as the NATO Charta and UNSC resolutions.⁶² The concern for human rights is translated into various organizations such as the UNSC and the UN General Assembly. In addition to this, there are multilateral international tribunals such as the World Trade Organisation panels, the International Court of Justice and regional courts like the European Court of Justice.⁶³ All these branches are rudimentary – there are no world lawmakers, there is not a single world court, and there are no world enforcers. The laws and resolutions cannot be fulfilled on an international level alone. This shows how crucial compliance at state level is, which is another sign of the overlapping and interdependence of state and transnational elements.

Keohane, with his focus on rules as an element of secondary institutions, hints at organizations as the setters of normative constraints. It is apparent that our study now enters a legal framework. When the primary institutions become institutionalized in international organizations, the norms will be trans-

58 Kratochwil, F.V., and Mansfield, E.D. (1994) *International Organization: A Reader*. (New York: HarperCollins College Publishers).

59 Ruggie, J. G. (1998) *Constructing the World Polity: Essays on International Institutionalization* (London: Routledge).

60 Keohane, R. (1988)

61 Ibid

62 Haljan, D.P. (2013) *Separating Powers: International Law before National Courts*. (The Hague: TMCAsser Press).

63 Ibid

lated into laws. Organizations attempt to regulate international politics by formulating laws.

This section points out that the survival of collective norms is an issue between international organizations and states. The arena for international society forming a response to terrorism is international law.

4.3. GLOBAL CONSTITUTIONALISM

To account for the encroachment of law in the international arena and its resulting complexity, a pluralist legal theory has been developed.⁶⁴ Legal pluralists view international law as an order where different legal systems interact. The interaction creates the international legal system.⁶⁵ In contrast to monist theory, this system is not hierarchical but horizontal. A pluralist conception incorporates different structures that create law and different cultural conceptions the law is rooted in. Most fundamentally it is open to change: legal conceptions change, react to structural shifts and find new balances in a constant debate. This dialectical conception fits the English School's conception of institutions and order and renders it possible to analyze the interaction of ECJ and UNSC in the *Kadi* case. English School and pluralist theory are, therefore, similar in their moral skepticism, and their emphasis on normative change through discourse expresses them.

In *Kadi*, two legal orders overlap; the UN system creates a law and the EU system needs to enforce it. The case of Mr. Al-Kadi exploits normative tensions between a UN focus on security and an EU focus on individual rights. A court had to judge how both orders interact.⁶⁶ These dynamics in a pluralist legal framework can be compared to the concept of a balance of power. In *Kadi*, we see a balancing mechanism in a constitutional way between two institutions.⁶⁷ The message is the same – only in a balance, we can achieve order. In the legal case, a normative balance is preventing any legal system from being more powerful than any other.

Following a pluralist paradigm, we can make sense of *Kadi* as a development of what Wiener calls “global constitutionalism”, an emerging constitutionalization of the global system,

64 Not to be confused with the notion of pluralism in the English School.

65 Lang, A. (2013) “Global Constitutionalism as Middle Ground Ethics.” In Navari, C. (ed) *Ethical Reasoning in International Affairs: Arguments from the Middle Ground* (Basingstoke: Palgrave Macmillan).

66 Ibid

67 Ibid

where international organizations increasingly formulate their own laws.⁶⁸ As a result of the ongoing interaction between different political and legal arenas in an international society, international relations first become globalized relations and then constitutionalized relations.⁶⁹ This creates the danger of “unbound constitutionalism”, and a quantitative increase in the legal terms organizations are formulating is accompanied by a lack of coordination and consensus. This coordination is necessary in order to balance norms with others and to create a consistent and consensual regime. A cacophony of international regulations is spreading.

Global constitutionalism sits at the border of law and politics as the international society sits at the border of norms and politics. Global constitutionalism can be seen as an extension of the English school into the world of secondary institutions. Applying Wiener’s concept of unbound constitutionalism, the international society needs to regulate the spread of constitutional norms before they become contradictory, dispute, and undermine legal order. Unbound constitutionalism is nothing else than a self-betraying overreaction translated into legal terms. This brings us full circle to the RAFs strategy pointed out in the introduction. If norm contestation grows exuberantly, norms lose their power – what is a norm that is unaccepted? Then order is threatened by the chaos of unconvincing norms. By using the pluralist framework, we can analyze scenarios where different legal orders engage in norm recognition or norm contestation. One of them is the *Kadi* case.

This discussion attempts to clarify how tensions on the legal level are expressed by introducing the pluralist legal theory and global constitutionalism. Being problematic on one hand by leading to a normative chaos, these concepts also open the path for a solution – the international society can renegotiate legal tensions by a normative balancing between legal orders. If different legal layers signal their disagreement, then legal tensions can be smoothed out dialectically. Coming back to the question of who watches the watchmen it can be argued that they watch each other, therefore international organizations shield off the risk of a unilateral state overreaction and pluralist law helps to avoid an overreaction by the organizations themselves.

These analytical discussions provide a theoretical toolbox

68 Wiener, A. et al (2012) “Global Constitutionalism: Human Rights, Democracy and the Rule of Law.” *Global Constitutionalism* (Vol: 1, no. 1) 1-15.

69 Ibid

to analyze *Kadi* and the English school offers the concepts of order and the society of states defending it. Thereby it links norms with politics. Buzan's "update" allows us to give it a contemporary and more inclusive spin illustrating the nature of the world *Kadi* is a part of. "New terrorism" fits into this dualism because it is, on one hand, a systemic and fundamental threat to the old "international society" and is able to unleash the most excessive response. On the other hand, it is also an expression of the transnational world the international society has entered. The response to terrorism must come from IOs, which are the extension of primary institutions. The interaction of the international legal system is the place where international norm change takes place. This is a problem for the cohesion of international society when it not only promotes unbound constitutionalism but also offers a solution.

5. ANALYZING THE *KADI* CASE

5.1. AN INSTITUTIONAL SHIFT

The constitutionalization of international organizations was set off by the end of the Cold War. Until then the rivalry of the superpowers dictated the agenda of the United Nations bodies. At the beginning of the 1990s "great power unity" was formed. A system of collective security in the form of the UNSC now relatively freed of reflex vetoes to oppose the other superpowers could take action in many areas.⁷⁰

After a short moment of "end of history"-triumphalism,⁷¹ the 1993 World Trade Centre bombings, the 1998 US Embassy bombings, and the attack on the USS Cole in 2000 made international terrorism move up the UN security agenda.⁷²

However, it was not until 9/11 that a normative balance between human rights and security was maintained. This balance was changed profoundly by the events of 9/11 and served as a political and legal fault line for the international society.⁷³

Manusama identifies four phases of terrorism moving up the agenda. First (1990-1994) terrorism was seen as a side effect

70 Manusama, K. (2006) *The United Nations Security Council in the Post-Cold War Era: Applying the Principle of Legality*. (Leiden: Martinus Nijhoff).

71 Fukuyama, F. (2006) *The End of History and the Last Man*. (New York: Free Press).

72 Foot, R. (2007) "The United Nations, Counter Terrorism and Human Rights: Institutional Adaptation and Embedded Ideas." *Human Rights Quarterly* (Vol: 29, no. 2) (2007): 489-514.

73 Manusama, K. (2006) *The United Nations Security Council in the Post-Cold War Era: Applying the Principle of Legality*. (Leiden: Martinus Nijhoff).

of rogue state behavior. Resolution 748 on Libya determined its activities as a threat to peace for single other states and with respect to Libya's harboring of terrorists. In this phase, terrorism was seen as a part of rogue state strategy.

Second (1994-2001), the Security Council reiterated more generally that "every member has the duty to refrain from organizing...terrorist acts in another state". In this phase, not the act of terrorism itself but only its utilization by states was seen as a threat to peace.

It was only in the third phase (2001-2002), starting on 12 September 2001, that this perception shifted and that individuals as sources of international terrorism came into focus. On this day, the Security Council adopted resolution 1368, determining that any act of international terrorism is a threat to international peace independent of its scale and source.⁷⁴ This is a major shift that departs from the state-focus and also from the qualification that only some terrorist acts pose a threat. Resolution 1368 justifies targeting any individual involved in any kind of international terrorism in a global regime.

In the final step beginning in 2002 with resolution 1456, the UNSC condemned "terrorism in all its forms and manifestations"⁷⁵ stripping away the qualification of "international" terrorism.

The constitutionalization of the UNSC before this third phase was rather limited. The normative balance of the international society was undisturbed. Before 9/11 the focus lay on stopping state-sponsored terrorism by ensuring state responsibility to tackle issues like Lockerbie, the bombing of an Airbus over Scotland. Up to this point, individuals were protected, and terrorism was seen as a problem caused by states.

This balance was embedded in an era when the international society was profoundly "thickened" by an ever-interdependent economy, a growing concern for human rights (the "Responsibility to Protect"), and growing solidarist consciousness.⁷⁶ In the 1990s, the individual became increasingly regarded as a direct member of international society and holder of individual rights by its mere existence as a human.⁷⁷ Following the proto-solida-rist reinterpretation of Bull by Buzan, we can trace here how

74 Ibid

75 Ibid, P.113

76 (2013) "Change and Insecurity' Reconsidered." In Croft, S. and Terriff, T. (eds.) *Critical Reflections on Security and Change 1-17*. (London: Routledge).

77 Jørgensen, K. E. (2010) *International Relations Theory: A New Introduction*. (Basingstoke: Palgrave Macmillan).

sovereign states allowed solidarist norms to appear.

The measures implemented after 9/11, however, target individuals directly without offering them any legal recourse and, therefore, symbolize a major break in UNSC legislation.⁷⁸ Also, the scope and impact of the measures already in place were significantly increased after 9/11.⁷⁹

In summary, international terrorism has evolved from rogue state strategy (Ph. 1) with states having the duty to refrain from applying this (Ph. 2) to an issue where terrorist activities as such are a major threat to international peace (Ph. 3 & 4) in the post 9/11-world. After 9/11 individuals themselves are targeted; meaning anyone involved in any kind of terrorism. Only through this change can individuals like Mr. Al-Kadi be convicted even if it cannot be proved that they were part in a specific attack, but simply by their alleged (and undisclosed) involvement in terrorism in general. Bull's concept of the international society offers the backdrop for Manusama's observations allowing the projection of normative changes in the community of states.

6.2. RESOLUTION 1267

Resolution 1267 (R1267) plays a major role in this shift, which disturbed the solidarist setting of the pre-9/11 world. R1267 forms a part of counterterrorism finance measures by issuing sanctions on terrorism suspects. The resolution was already imposed in 1999. Before 9/11 the resolution was focused very restrictedly on the Taliban.⁸⁰

After 9/11 the resolution came out of the shadows and developed a more profound impact on the balance of security and human rights. Before 9/11 only one "consolidated list" of targeted individuals and organizations was published including 162 people.⁸¹ Within days after 9/11, R1267 was transformed. An additional list including 206 individuals and 74 companies was added. This list included Mr. Al-Kadi.⁸² By July 30th, 2010 the list

78 Van Den Herik, L. (2007) "The Security Council's Targeted Sanctions Regimes: In Need of Better Protection of the Individual." *Leiden Journal of International Law* (Vol: 20, no. 4) 797-807.

79 Dewulf, S. and Pacquee D. (2006) "Protecting Human Rights in the War on Terror: Challenging the Sanctions Regime Originating from Resolution 1267 (1999)." *Netherlands Quarterly of Human Rights* (Vol: 24 No. 3) 607-634.

80 Ibid

81 United Nations Security Council (2008) "Security Council Al-Qaeda and Taliban Sanctions Committee Concludes Review of Its Consolidated List, Pursuant to Resolution 1822 (2008)" (Online) www.un.org/News/Press/docs/2010/sc9999.doc.htm. (Assessed: 20 August 2015).

82 Cooper, C. (2002) "Shunned in Sweden: How Drive to Block Funds for Terrorism Entangled Mr. Aden." *Wall Street Journal*, 6 May 2002.

had grown threefold in size.⁸³

Cooper quotes an anonymous diplomat, “In the immediate aftermath of 9/11, there was enormous...willingness to [take on] trust any name that was submitted...It was a re-orientation of the sanctions regime, focusing on people who weren’t even members of guerrilla groups”.⁸⁴

It was after 9/11 that other countries attempted to use the R1267 regime for their own political campaigns,⁸⁵ for example, Russia wanted to include Chechen rebels. China tried similarly to bolster its campaign in the Xinjiang province. Egypt pointed out that it had its own fight against terror, and the Israelis referred to Arafat as “our bin Laden”.⁸⁶

Although R1267 was adopted in the second phase of the development, it can, therefore, be argued that it gained real political momentum after 9/11, increasing in global reach and attributing unprecedented power to the UNSC.⁸⁷

Seen through our framework R1267 is a sign of global constitutionalism. The UNSC made decisive moves towards a constitutionalization of their response to terrorism. Instead of globalized relations where states interact within the Security Council as an arena and an extension of their interests, we witness constitutionalized relations where the Security Council itself is increasingly the source of these rules. By slowly departing from being a strict state extension, (even) the UNSC symbolizes a shift towards a transnational society. R1267 bears this transnational dynamic by focusing on non-state actors independent of states. Both changes can be exactly located in Phase 3 or in other words around 9/11.

This chapter has shown that 9/11 has had a profound impact by leading the UNSC to a legal paradigm shift targeting individuals causing potential attacks. R1267 has been a major part of this. The developments started before 9/11 but until this attack, a relative stability was sustained. After 9/11 the notion of

83 European Center for Constitutional and Human Rights, Berlin (2010) “Blacklisted: Targeted Sanctions, Preemptive Security and Fundamental Rights.” (Online) ECCHR-Report <http://www.ecchr.eu/en/documents/publications/ecchr-publications/articles/blacklisted-targeted-sanctions-preemptive-security-and-fundamental-rights.html>. (accessed: 19 August 2015).

84 Cooper, C. (2002)

85 Schorlemer, S. (2003) “Human Rights: Substantive and Institutional Implications of the War Against Terrorism.” *European Journal of International Law* (Vol: 14, no. 2) 265-82.

86 Human Rights Watch, New York (2002). “Human Rights Watch World Report.” (New York: HRW Publishing).

87 Dewulf, S. and Pacquee D. (2006) “Protecting Human Rights in the War on Terror: Challenging the Sanctions Regime Originating from Resolution 1267 (1999).” *Netherlands Quarterly of Human Rights* (Vol: 24 No.3) 607-634.

security has fundamentally gained weight at the costs of individual rights, as the next chapter will show.

6.3. THE ATTACK ON HUMAN RIGHTS

Several authors have compared the situation of Al-Kadi with Mr. K's experience in Kafka's "The Trial."^{88,89} An inaccessible authority persecutes Mr. K, the reasons being neither revealed to him nor to the reader.⁹⁰ Kafka's book is an attack on totalitarianism; the similarities to *Kadi* inform us about the profound weakening of individual rights following R1267.

The basic element of the resolution is a listing mechanism, in which the committee can designate a person as linked to Al Qaeda once one state has submitted their name and no objection is received within 48 hours. Then states are obliged to freeze financial assets and deny entry into and transit through their territories.⁹¹ The individual is not heard before or after the decision is made and the listing offers an absolute minimum of information, due to security concerns.⁹² Further, there is no explanation as to what kind of proof is required to put someone on the list.⁹³ All that is known is that the list contains names of subjects that are thought to be "associated with" Al Qaeda or the Taliban.⁹⁴

There are three bases of criticism against this resolution. From the perspective of administrative law, the resolution's procedural requirements for adding names are too vague.⁹⁵ The second critique comes from a rule of law perspective. Dyzenhaus argues that the resolution violates fundamental principles of legality by not formally separating legislature and judiciary and by applying laws retrospectively.⁹⁶ Third, the resolution challenges a range of established human rights⁹⁷ such as the right to

88 Schutze, R. (2013) "Coda: Kafka, Kadi, Kant." (Online) SSRN Scholarly Paper <http://ssrn.com/abstract=2324574> (Assessed: 20 August 2015).

89 Mason, L. (2014) "The Intractably Unknowable Nature of Law: Kadi, Kafka, and the Law's Competing Claims to Authority." In Avbelj, M. et al. (eds) *Kadi on Trial: A Multifaceted Analysis of the Kadi Trial*, (London: Routledge, Taylor & Francis Group).

90 Kafka, F. (2000). *The Trial*. (London: Penguin).

91 Powell, C. (2007) "The Legal Authority of the United Nations Security Council." In Goold, B.J. and Lazarus, L. (eds) *Security and Human Rights* (Oxford: Hart).

92 Dewulf, S. and Pacquee D. (2006) "Protecting Human Rights in the War on Terror: Challenging the Sanctions Regime Originating from Resolution 1267 (1999)." *Netherlands Quarterly of Human Rights* (Vol: 24 No. 3) 607-634.

93 Ibid

94 Ibid, P.619

95 Powell, C. (2007)

96 Dyzenhaus, D. (2005) "The Rule of (Administrative) Law in International Law." *Law and Contemporary Problems* (Vol: 68, no. 3) 127-66.

97 Powell, C. (2007)

freedom of movement (Art. 13 UDHR), the right to property (Art. 17), and the right to due process (Art. 11.1.). All these breaches combined lead to the Kafkaesque situation of Al-Kadi.

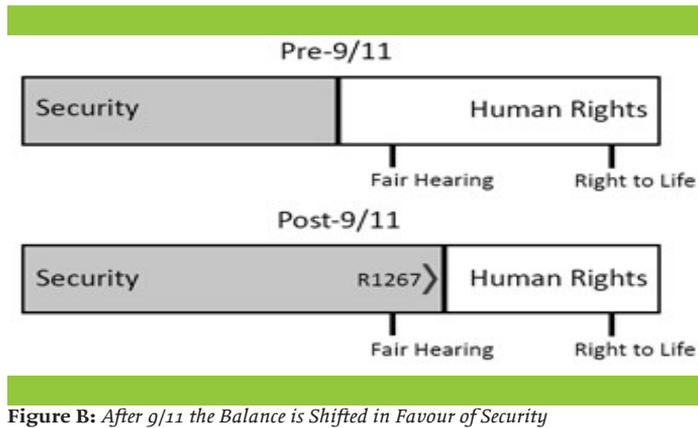


Figure B: After 9/11 the Balance is Shifted in Favour of Security

Whether these critiques are attacking the UNSC’s legitimacy is an ongoing debate. The main bones of contention are whether the council is above these legal standards^{98,99} and in addition whether international law needs to be treated like national law at all.¹⁰⁰ This debate, however, is not relevant here. Since the resolution needs to be incorporated into other legal frameworks, the normative tension is passed on. These orders must recognize the implications of the resolution and cannot escape the legal concerns they are undoubtedly bound to.

One of these orders is EU law. The stage is set for what Lang described above as legal balancing; the EU either strengthens or weakens the UNSC attack on human rights. The UNSC council is very well aware of this. Special Rapporteur on Human Rights Scheinin highlights that states have the onus to prove that a fair hearing is restricted on concerns of national security.¹⁰¹ The conundrum of how a court can transparently prove this when no further information is provided or allowed to be shared is passed on to the EU lawyers as well. To comply with R1267 the European Union passed regulation 881/2002 implementing the sanctions automatically. This transition from UN to EU law

98 Reisman, W. M. (1993) “The Constitutional Crisis in the United Nations.” *The American Journal of International Law* (Vol: 87, no. 1) 83-100.

99 Rosand, E. (2005) “The Security Council as ‘Global Legislator’: Ultra Vires or Ultra Innovative?” *Fordham International Law Journal* (Vol: 28, no. 542) 542-90.

100 Koskenniemi, M. (2002) *The Gentle Civilizer of Nations: The Rise and Fall of International Law, 1870-1960*. (Cambridge: Cambridge University Press).

101 Van Den Herik, L. (2007) “The Security Council’s Targeted Sanctions Regimes: In Need of Better Protection of the Individual.” *Leiden Journal of International Law* (Vol: 20, no. 4) 797-807.

is the link *Kadi* is challenging. This is the point where different legal orders overlap and the UNSC weakens individual rights¹⁰² but depends on states and regional organizations such as the ECJ to follow this shift.

Through our framework, the confrontation of UNSC and ECJ is a manifestation of the border between politics (UNSC) and law (ECJ). Klabbers underlines this by arguing that the UNSC is “living on a knife’s edge there is no law, there are only decrees, to be applied by the powers that be”.¹⁰³ (2007 P.11). But still, this hybrid between law and political decision has a profound legal impact when it transfers its decrees to regional courts, which are much more obligated to follow legal standards. The result is an issue of cooperation – if other courts do not accept the resolution, counterterrorism measures cannot be implemented. In this situation, the intention of fighting terrorism through counterterrorism finance is well meant but badly done. If these orders accept the resolution, then they violate their own fundamental norms and the case of normative self-betrayal emerges.

This chapter has reviewed how R1267 is a profound attack on the international society’s established norms, not only in terms of human rights but also for more overarching principles such as administrative law and the general principle of legality.

It is up to regional institutions to either balance this out by contesting the decision or to cooperate by recognizing new norms.¹⁰⁴ In this case, Bull’s link between norms and politics becomes highly critical for the survival of the counterterrorism regime.

This ability to balance in a pluralist legal framework shows the fundamental difference between Kafka’s dystopia and the real world. In the latter, law is able to “redeem” itself by renegotiation.¹⁰⁵ The *Kadi* case is essentially such a move to save legal stability, as will be shown in the next section.

6.4. RENEGOTIATING THE BALANCE IN THE KADI CASE

In its decision (*Yassin Abdullah Kadi v. Council*), the ECJ

¹⁰²This is a necessary simplification. The UNSC does recognize human rights as any other IO. However, they differ in their interpretations of an adequate balance with security concerns.

¹⁰³Klabbers, J. (2008) “Kadi Justice at the Security Council?” *International Organizations Law Review* (Vol: 4 no.2) 293-304.

¹⁰⁴Wiener, A. et al (2012) “Global Constitutionalism: Human Rights, Democracy and the Rule of Law.” *Global Constitutionalism* (Vol: 1, no. 1) 1-15.

¹⁰⁵Mason, L. (2014) “The Intractably Unknowable Nature of Law: Kadi, Kafka, and the Law’s Competing Claims to Authority.” In Avbelj, M. et al. (eds) *Kadi on Trial: A Multifaceted Analysis of the Kadi Trial*, (London: Routledge, Taylor & Francis Group).

argues that the R1267 violates the fundamental principles of the rule of law and thereby human rights.¹⁰⁶ First, when Al-Kadi approached the EU Court of First Instance, the latter held that the obligations to the UN Charter prevail over EU human rights guarantees. In Al-Kadi's appeal, the ECJ reversed the CFI's decision by arguing that the obligations could prevail over EU guarantees for human rights because EU law is an independent constitutional legal order.¹⁰⁷ Essentially the ECJ argued that the independence of its legal order is to be defended even if this comes at the price of UN member states limiting their international responsibility:

[T]he review by the Court of the validity of any Community measure in the light of fundamental rights must be considered to be the expression, in a community based on the rule of law, of a constitutional guarantee stemming from the EC Treaty as an autonomous legal system which is not to be prejudiced by an international agreement. The question of the Court's jurisdiction arises in the context of the internal and autonomous legal order of the Community, within whose ambit the contested regulation falls and in which the Court has jurisdiction to review the validity of Community measures in the light of fundamental rights. (Yassin Abdullah Kadi v. Council, 316-317)

After this decision, the Security Council gave a positive response by establishing an appeal procedure. A new resolution, 1904, created an ombudsperson's office in December 2009. Individuals contesting the listing can contact this person and receive assistance before the sanctioning committee. Listed people can also appeal to their state, which can then bring the case to the sanctioning committee, where the chance to be heard is then higher.¹⁰⁸

According to Kratochwil, this is a sign of the Security Council conceding in favor of individual rights and accepting the ECJ renegotiation. He argues that with R1904 the UNSC indeed alleviated some of the most problematic effects of R1267 and reduced legal tensions.¹⁰⁹ Kratochwil concedes that this is

¹⁰⁶ Kratochwil, F. V. (2014) *The Status of Law in World Society: Meditations on the Role and Rule of Law*. (Cambridge: Cambridge University Press).

¹⁰⁷ Milanovic, M. (2009) "Sayadi: The Human Rights Committee's Kadi (or a Pretty Poor Excuse for One...)." (Online) Blog of the European Journal of International Law <http://www.ejiltalk.org/sayadi-the-human-rights-committee%E2%80%99s-kadi-or-a-pretty-poor-excuse-for-one%E2%80%A6/>. (Assessed: 20 August 2015).

¹⁰⁸ Kratochwil, F. V. (2014) *The Status of Law in World Society: Meditations on the Role and Rule of Law*. (Cambridge: Cambridge University Press).

¹⁰⁹ Ibid

still a far cry from an effective remedy.¹¹⁰ A sobering moment is provided by the *Sayadi* case.¹¹¹ Nabil Sayadi, a Belgian born in Lebanon and his wife are the managers of a charity, which was put on the sanctions list in 2002. The Sayadis asked the Belgian government through a Belgian court to initiate delisting procedures. By doing this they were using the R1904 innovation. The Belgian government followed this request. Before the committee, Belgium raised several articles of the International Covenant on Civil and Political Rights (ICCPR), claiming their violation. However, the UNSC refused to delist the Sayadis without giving any further reasons. In defense of the ECJs success with *Kadi*, it is important to point out that *Kadi* and *Sayadi* are not following the same legal path. The ECJ argued as a constitutionally independent institution defending its autonomy. The ICCPR is not at all independent of the UN Charter; it is, in fact, a UN-treaty. *Kadi* is a sign of renegotiation between legal spheres, whereas *Sayadi* by referring to ICCPR is focusing on an internal tension in UN law.¹¹² The latter strategy proved not to be successful.

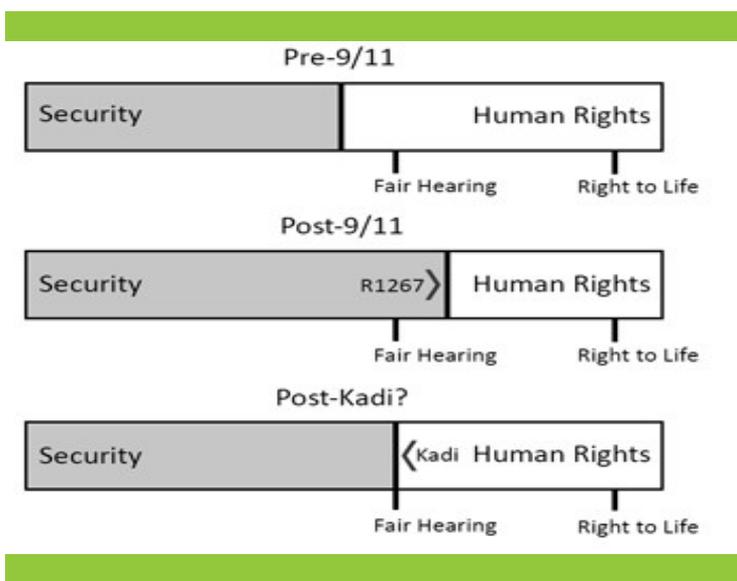


Figure C: *Kadi* Shifts the Balance Back in Favour of Human Rights

¹¹⁰ Ibid

¹¹¹ Stein, T. (2012) "Too 'Smart' for Legal Protection? UN Security Council's Targeted Sanctions and a Pladoyer for Another UN Tribunal." In Hestermayer, H. (ed) *Coexistence, Cooperation and Solidarity: Liber Amicorum Rüdiger Wolfrum* (Leiden: Martinus Nijhoff Publishers).

¹¹² Milanovic, M. (2009) "Sayadi: The Human Rights Committee's *Kadi* (or a Pretty Poor Excuse for One...)." (Online) Blog of the European Journal of International Law <http://www.ejiltalk.org/sayadi-the-human-rights-committee%E2%80%99s-kadi-or-a-pretty-poor-excuse-for-one%E2%80%A6/>. (Assessed: 20 August 2015).

Despite this legal difference, it still might be a sign that the backshift *Kadi* was causing was rather small barely going beyond the right of a fair(er) hearing. Still, *Sayadi* does not disprove this paper's argument of an increasing balance per se. It rather adds a sobering note in two ways. First and quite obviously, the legal argumentation matters in the delisting procedures. Second, what counts for Mr. Al-Kadi might not count for others. It can be argued that a complete shift e.g. by delisting anybody, would have been another overreaction of international society, in the opposite direction. This would mean sacrificing security interests for the sake of individual rights. Dialectically the UNSC and the ECJ found a balancing point with R1904 amending R1267. Time will tell if cases like *Sayadi* will continue to overshadow *Kadi*. Until then it remains notable that with R1904 the UNSC gave in to individual rights and increased a normative consensus in international society.

7. UNDERSTANDING *KADI*

7.1. *KADI* AS LEGAL BALANCING

Turning to the discussion of the case, the ECJ decision can be incorporated in the presented framework of an international society with strong transnational elements. The findings suggest that ECJ serves as an institutional balancer by attempting to preserve the cohesion of international society.

As an autonomous legal system, the ECJ limited the UNSCs approach to further constitutionalize their actions without renegotiating it with other legal orders. UN resolutions require the cooperation of other legal systems especially when it comes to a complex issue of global governance like terrorism. These different legal systems are not subordinated, but autonomous, as the ECJ argues.

The English School framework found what it set out to discover – a mechanism to manage normative tensions in the face of external shocks. It can be interpreted that with the decision, the ECJ is giving the UNSC a warning shot by partly undermining its hierarchy.¹¹³ Through this balancing approach, the ECJ protects the individual's rights. Collectively, UNSC and ECJ create a legal order that defends the sovereignty of states but also protects the liberal rights of individuals. In a way, the ECJ tries to re-

113 Lang, A. (2013) "Global Constitutionalism as Middle Ground Ethics." In Navari, C. (ed) *Ethical Reasoning in International Affairs: Arguments from the Middle Ground* (Basingstoke: Palgrave Macmillan).

verse the shift that appeared after 9/11. This approach shows the value of balancing out different institutions to achieve order, as conceptualized by Bull. Further, following Buzan, *Kadi* suggests that the international society is thickening again after being put on a diet by R1267. With R1904, the UN responds favorably by decreasing normative tensions. *Kadi* is, therefore, an integrative move to preserve the international society and to prevent it from stepping into the trap envisioned by the RAF. This mechanism is placed at the intersection of legal spheres. The role of pluralist law can be explained with the growing impact of IOs and the accompanying development of global constitutionalism.

7.2. THE EMPIRICAL QUESTION

There are a number of empirical implications resulting from the analysis of *Kadi*. First, it redesigns the security human rights dyad by showing how the response to terrorism is not only attacking human rights, but also other legal standards. Therefore, for the debate on terrorism, it is important to analyze how counterterrorism challenges the rule of law in a more holistic manner instead of focusing solely on human rights.

Second, *Kadi* illustrates the fragility of the solidarist framework. It is worth noting how fast human rights concerns can be swept away by changes such as the attack on the World Trade Centre. The R1267 regime underlines Buzan's observation that pluralist elements are stable, but solidarist ones are much more shallow.¹¹⁴ The practical implication for both policy-maker and analyst is to be aware of this fluidity.

The third implication shifts our attention to the regulation of international organizations showing that the increasing independence of IOs lacks a normative dimension.¹¹⁵ Klabbers argues that these unregulated bodies could end up "doing the dirty work for states" in a normative vacuum.¹¹⁶ International organizations need a normative framework on which to be measured. As this study shows, the English School offers a normative perspective on this issue.

7.3. THE THEORETICAL QUESTION

114 Buzan, B. (2004) *From International to World Society? English School Theory and the Social Structure of Globalisation*. (Cambridge: Cambridge University Press).

115 Klabbers, J. (2008) "Kadi Justice at the Security Council?" *International Organizations Law Review* (Vol: 4 no.2) 293-304.

116 *Ibid*, P.11

As pointed out in the introduction, *Kadi* also offers implications for the English School framework. First, the findings may help us to understand the potential of English School theorizing for issues of global governance. The results of this study show the importance of Buzan’s “updates” to the classical approach by using the concept of a transnationalizing society increasingly working on the level of international organizations and appealing to individual rights. But they also underline the importance of the sound foundation laid by Bull with regards to normative institutions, their dynamics between each other, and their impact on general order. In *Kadi*, the ECJ argues completely on behalf of the “community” (i.e. European), not on behalf of single states, to drive forward a consensus in international society. In order to restore the cohesion of common norms, the ECJ made a point for human rights, independent legal orders, and global pluralist balancing. Hence, from the English School perspective, *Kadi* provides a corrective to avoid an excessive focus on sovereignty at the costs of human rights by including a balance of power between both institutions.¹¹⁷ The analysis shows that the English School with its simultaneity of the three traditions and its emphasis on norms has the potential to cover complex issues of global cooperation such as terrorism.

Second, this study points to the limits of the English School; if their interpretations stick solely to an international society approach and ignore the elements of world society they lose explanatory power for current issues such as the global response to terrorism. The same accounts for interpretations, which ignore the study of international organizations (i.e. secondary institutions). The potential of the English School expressed in its three traditions and its study of normative clusters is limited if it does not open up for an arena that is increasingly transnational and inhabited by organizations.

Third, *Kadi* offers deeper insights into how the theoretical concepts account for the real world. One theoretical finding is on the clash of institutions. We can synthesize that the tension between security and human rights was implicit before. The UNSC was having a hard time defining terrorism and was reiterating its evaluation, the sources, and the necessary consequences. It was expressing a kind of confusion by vehemently trying to put the problem into “state” boxes.¹¹⁸ Still, this implicit tension did not

¹¹⁷ Lang, A. (2013) “Global Constitutionalism as Middle Ground Ethics.” In Navari, C. (ed) *Ethical Reasoning in International Affairs: Arguments from the Middle Ground* (Basingstoke: Palgrave Macmillan).

¹¹⁸ Lang, A. and Russell Beattie, A. (2009) *War, Torture and Terrorism: Rethinking the Rules of International Security* (London: Routledge).

lead to a clash until 9/11. A general balance between both institutions was preserved despite implicit tensions. Only when these tensions became highly politicized did norms start to collide. Therefore, in international society institutions can coexist with tensions as long as they are not brought up on a political agenda. R1267 did not create the tension itself, but it turned an existing tension into an actual problem for international society.

7.4. THE WIDER DEBATE

This study suggests answers for the wider debate about international society and terrorism. *Kadi* shows that for the explanandum of the international societies' response to terrorism we have to focus on the domain of international law and global constitutionalism as the explanans. In international law, the norms are codified. Potential normative clashes can, therefore, be discovered through legal analysis.

An overreaction can thus be framed under Wiener's "unbound constitutionalism". This offers insights into how this indirect threat works on an international level; the "unbound" constitutionalization of practices by international organizations such as the UNSC can lead other legal actors to a normative contradiction. Therefore, the source of this normative clash is not the international level, but the location is the regional and national legal level where such "overreacting" measures have to be justified and implemented. This study refutes the conjecture that *Kadi* is already showing a breakdown of international society. Much to the contrary, *Kadi* shows that there are mechanisms working towards a balance. This adds an illustration to the theories of the English School by connecting the idea of institutional dynamics with practical evidence from global constitutionalism.

These findings raise further questions for the problématique of terrorism in the international society. It can be argued that an overreaction can come from two directions. If the ECJ had convinced the UNSC to cancel R1267 completely this would have caused dissent with other actors. Further, it would have led to a direct terrorist threat by becoming too vulnerable. Balancing, therefore, is very delicate, involves a wide range of legal spheres and takes a considerable amount of time and coordination. This complexity has the potential to lead the attention away from international organizations as problem solvers and back to state action. When patience lacks, leaders might follow the logic of "what we can't solve legally, we will solve unilaterally" (e.g.

with drones). How can a legal framework still keep its legitimacy when it requires complex and time-consuming renegotiation mechanisms? How can we make sure that terrorists do not exploit this normative weakness? Despite the fact that it has been argued that issues like terrorism cannot be solved unilaterally when time is tight, an international framework might be too complex. Is this model then only a fair weather approach? If so, how can we create structures that remain powerful in times of urgency, when normative tensions very suddenly become politically relevant?

8. CONCLUSION

The adequate response to terrorism is a topic of interest for scholars and policymakers across a wide range of disciplines. Within the field of IR, understanding how political and normative concerns are intertwined on transnational levels is of great concern. Buzan argues prophetically “for now and for some decades to come, the interesting question is about how the state and the non-state worlds do and will interact with each other”.¹¹⁹ The analysis of a collective response to terrorism in general and the *Kadi* case specifically is at this intersection of state and non-state worlds. Although often underutilized when discussing global governance issues, the English School can provide a useful framework for the legal conflict between the UNSC and the ECJ. The concept of states as a normative community linking ethics and politics allows it to address questions which are overlooked by other theories.

This study has shown that the international society can fall into a state of normative confusion lured by an external threat of terrorism and accompanied by the phenomenon of unbound constitutionalism. The *Kadi* case is explained as a way to restore a consistent institutional balance with a legal order that defends the sovereignty of states but also advances the liberal rights of individuals.

Following an examination of the applicability of the English School and the discussion of different approaches within this theory, the study first demonstrated how the *Kadi* case fits within this paradigm. Second, it further modified this framework by adding insights from institutionalism, the study of terrorism, and most importantly insight from scholars of global

¹¹⁹ Buzan, B. (2004) *From International to World Society? English School Theory and the Social Structure of Globalisation*. (Cambridge: Cambridge University Press).

constitutionalism. Third, when applied to the case study, this framework offered insights into the counterterrorism efforts from 1990-2009. Following the argument that an institutional balance was preceding the attacks on September 11th, 2001, it showed that R1267 disturbed this balance. This had the potential to cause a normative “overreaction”, as fantasized by the RAF group. The *Kadi* case gives the international society the chance to redeem itself, by restoring a consensus on the balance between security concerns and human rights.

A note of caution is due regarding the results of this study. As the timeframe has shown, the processes of norm-change and rebalancing take years if not decades to show their effects. The effects of 9/11, the *Kadi* case, and even more so R1904 are still very recent matters in the international society. Therefore, the findings are limited by temporal proximity. Only time will tell if the effects of *Kadi* continue to show a shift in strengthening individual rights after the attack of R1267. The results, therefore, need to be interpreted with caution.

Further, this proximity highlights important issues for future research. Research questions could include the sustainability of *Kadi*, and a comparative approach including other events of legal balancing. Now that Jihadi terrorism is mostly bound into the sectarian violence in the Middle East after the Arab Spring, it might be asked how this changes an adequate response from international society. This “third wave of Jihadism”¹²⁰ again changes the structural environment; terrorist attacks in the West are now increasingly low-scale and “home-grown”. R1267, aiming to fight terrorism by cutting financial flows, already seems outdated in a time where low-cost attacks like the Hebdo shooting in Paris are on the agenda. After Devetaks “new terrorism”, we now witness an even newer terrorism and again the international society must collectively respond to these changes.

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120 Gerges, F. (2014) “ISIS and the Third Wave of Jihadism.” *Current History* (Vol.113, no. 767) 339-43.

5. 2. Germany amidst the Critical Uncertainty of European Union Integration: An Alternate Scenario Analysis

SUBMITTED BY

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ABSTRACT

The history of Germany from National Socialism in the 20th century to the present day following unification has demonstrated a particular sense of continuity with respect to the way Germany views itself in comparison to its European neighbors. The prospects of further European Union enlargement are indicative of the fact that no definitive European borders exist. Chancellor Merkel's Germany is stuck at a crossroads in which its previous experiences with true hard power collide with the trajectory of future integration. The years ahead are likely to prove tumultuous as a volatile and unpredictable Russia will continue to compromise Germany's energy, security, and trade relations on its eastern flank. In terms of Germany's more traditional trade partners, namely western European nations, and the United States, emerging domestic issues impede political cooperation. This set of scenarios employs a focus on Germany's future paralleling its past to the extent that a specific analysis will be done on the domestic politics in Germany along with how the country interacts with global economic stresses, migration, and regional challenges on its periphery. The set of scenarios (3) aims to apply a combination of knowledge and unique perspectives to reduce future uncertainty and mitigate risk from potential surprises.

1. SCENARIO ONE: EU RENATIONALIZATION AND INTERGOVERNMENTALISM

1.1. INTRODUCTION

Germany is faced with a turbulent reality in which its insistence on multilateral diplomacy is being challenged by emerging and existential crises. The year 2014 was a determining point for Chancellor Angela Merkel as Russian President Vladimir Putin's annexation of Crimea called into question the European Union's geo-economic relationship with Russia.¹ Partially as a result of the Eurozone crisis, global economic stagnation, and a divergence of European interests and responses to political crises, Germany began to move towards furthering its own interests, while remaining adamant about employing austerity measures. Germany's response to the European migrant crisis has led to infighting among European Union states and is threatening the idea of an "ever closer Union".² The overall reaction from the migrant crisis has led EU states to employ various forms of identity politics rooted in reactionary nationalism. Domestically, the way Chancellor Merkel has dealt with the migrant crisis, including measures of austerity on fiscal policies, has led to divides in public opinion.³

Over the course of 2016, it has become apparent that the center-right Christian Democratic Union led by Merkel has lost a significant portion of its voting share in some areas in Germany, a loss that is expected to continue throughout the decade as the refugee crisis protracts. The discord over the migrant crisis, coupled with the failures of Merkel's multiculturalism project in Germany has led to an increase in right-wing populist movements, namely the Alternative for German Party (AfD) and the Patriotic Europeans Against the Islamization of the West (PEGIDA) street movement, which continue to gain momentum as the problem of integration looms. In fact, recent 2016 elections in Germany have led to the AfD having 14 percent of the vote in Berlin's 149-seat state assembly, setting the group on a potential path forward to the Bundestag.⁴ These factors combined with

- 1 "Russia officially annexes Crimea away from Ukraine with signature from Vladimir Putin," CBS News, March 21, 2014, accessed May 10, 2016, <http://www.cbsnews.com/news/russia-annexes-crimea-away-from-ukraine-with-signature-from-vladimir-putin/>.
- 2 "The Truth About the Migrant Crisis," Foreign Affairs, September 14, 2015, accessed May 8, 2016, <https://www.foreignaffairs.com/articles/western-europe/2015-09-14/truth-about-migrant-crisis>.
- 3 "Merkel at Her Limit," The Economist, October 10, 2015, accessed May 8, 2016, <http://www.economist.com/news/europe/21672296-after-historic-embrace-refugees-german-public-opinion-turning-merkel-her-limit>.
- 4 "Social Democrats receive most votes in Berlin election, AfD enters state assembly," Deutsche Welle, Septem-

Germany and many of the EU states enduring aging populations and the need to import large workforces to compensate for the decline in working-age populations will have a bearing on right-wing populist movements throughout the decade while exasperating anti-immigrant sentiment.

More importantly, the current state of affairs between Germany and other EU member states, given Germany's original post-cold war "reluctant hegemon" stance on global issues, has led to increased tensions considering Germany's emergence as a major player in foreign affairs. Notwithstanding Germany's remembrance of its daunting experience with true hard power, the geopolitical shift has caused Germany to taking a more assertive stance on crises occurring on its periphery. But the challenge to peace and prosperity within the EU demonstrates member states' unwillingness to cooperate on a number of issues. Germany's "push for a European defense" community and an EU army with joint militaries have been met with strong resistance by a number of nations in the region. This opposition against Germany's attempt to be a systems integrator illustrates a shift towards intergovernmentalist notions of state behavior.

Subsequent economic stagnation within the European Union has further alienated a number of member states. The failure of the euro and Eurozone has led to severe job losses and reduced incomes, as well as a wide margin of economic capabilities between many member states, which have increased incentives for states to act in terms of their own national interests, thus furthering the model of intergovernmentalism and inhibiting functionalism. Within the past few years, with China's economic slowdown and dismantling of industries, German markets have suffered significantly making Germany look elsewhere in the world to fortify its economic interests.⁵ Moreover, prospects of EU fragmentation become plausible following the United Kingdom's referendum decision to exit the European Union (otherwise known as Brexit), as countries such as Greece explore an exit from the EU too, albeit for different reasons. As the Eurozone continues to suffer stagnation, the European Central Bank (ECB) will continue to lower interest rates to increase consumer spending and overall money circulation, but progress will be slow as long as average unemployment within

ber 18, 2016, accessed September 30, 2016, <http://www.dw.com/en/social-democrats-receive-most-votes-in-berlin-election-afd-enters-state-assembly/a-19560261>.

5 Nina Adam, "German Exporters Shudder as China Economy Slows," *The Wall Street Journal*, January 28, 2016, accessed May 10, 2016, http://www.wsj.com/article_email/german-exporters-shudder-as-china-economy-slows-1454001140-lMyQjAxMTE2MDIzOTcyNDk1Wj.

the EU remains over ten percent. Simultaneously, Germany's constant opposition to the ECB's policies is reflective of the turn in German nationalist interests, whereby they continue to pressure the ECB to raise interest rates in order to increase foreign investment within Germany. What Germany does not take into consideration is that economically weaker countries within the monetary union will continue to suffer as austerity measures increase alongside rising interest rates. A heightening of economic strains has historically pushed countries like Greece, Ireland, and even Spain to consider an exit from the monetary and European Union. Furthermore, as the decade continues, Germany's stringent economic policies regarding the Eurozone and its unwillingness to allow governments to reduce austerity measures will result in continued dissent over Germany's role as a regional integrator.

As Germany grows in economic strength, Chancellor Merkel pushes unpopular processes for dealing with political and economic crises throughout the EU community. Due to the unwillingness of many EU states to deal with the European migrant crisis, Merkel struggles to maintain a welcoming European community, while countries institute restrictive asylum policies. Dismay throughout the EU over Merkel's EU-Turkey agreement to alleviate some of the massive influx of the Syrian refugee population echoes frustrations throughout the continent. The refusal of EU states to collaborate with Frontex, the EU agency that promotes and coordinates border controls amongst the EU states, on managing migrant flows across borders within the EU culminates into decisions by member states to implement their own domestic border restrictions, which is illustrative of the direct challenge to the Schengen Agreement and the idea of open borders. The changing dynamics of EU integration, along with changing ideations around nationalism, multiculturalism, and even assimilationist policies, continue to shape the future of German politics as Germany struggles to remain at the center of the integrationist model in Europe. The changing political landscape and acceptance, or lack thereof, of greater EU integration, a more assertive European Central Bank and a fragile monetary union will challenge Merkel's resolve as she attempts to leverage strategic relationships without sacrificing political capital.

1.2. DRIVERS OF THIS SCENARIO

The EU Renationalization and Intergovernmentalism Scenario

have emerged due to the effect of the following drivers:

Global Economy

The global economy experienced slow growth early in the decade. The thinning of Germany's working-age populations has weighed heavily on the country's prospects for economic growth. While Germany has increased the rate at which it receives immigrants into the country, growing populist rhetoric has reduced Merkel's ability to promote the further integration of new immigrant populations, thus inhibiting Germany's ability to meet workforce demands. Notwithstanding Germany's strong economy, the unequal distribution of wealth in Germany further exasperates rising anti-immigrant sentiment in the country, even considering the country's need to stabilize the effects that the aging workforce population has on its economy. Adding to that are the additional costs that the refugee influx will cause Germany to incur while trying to stimulate its economy. With globalization increasing the integration of markets, any of Germany's aggressive economic policies will likely face a backlash from other economic powers.⁶ Thus, the German economy will fight a two-front battle both within and outside of the European Union, making it significantly more difficult to continue to be at the center of it.

European Union Integration

The European Union has reached an impasse in which it has had to endure unprecedented waves of undocumented migrants and refugees, terrorist threats, and a Eurozone crisis. As these factors continue to threaten European integration, renationalization and a desire for intergovernmentalism are augmented by the rise of right-wing populist groups in Europe. With an "ever-closer union" becoming less a reality and the continent fragmenting politically, Germany struggles to remain at the center. Uncertainty about the British's continued involvement in the EU following Brexit along with other European states like the Czech Republic looking for a way out has fractured the integration that Germany has long pushed for. German austerity measures on economic policies relating to the EU coupled with its handling of the Syrian refugee crisis has weakened the EU's ability to robustly deal with the influx of undocumented migrants while leaving the continent vulnerable to Russian aggres-

6 Ian Talley, "US Chides Five Economic Powers Over Policies," *The Wall Street Journal*, April 30, 2016, accessed May 10, 2016, <http://www.wsj.com/articles/u-s-warns-five-economic-powers-over-policies-1461960876>.

sion. A growing populist sentiment throughout Europe continues to challenge any progressive policies that Germany hopes to implement leaving it at odds with many EU member states. The future of the integration of the European Union is likely to be at odds owing to both German domestic politics along with their aggressive policies within the EU.

Domestic Politics

The enduring European migrant crisis, which includes the Syrian refugee crisis as well as migrants and refugees fleeing other North African regions, has divided public attitudes in Germany. Dissent on how Merkel is handling the crisis has increased as right-wing populist political parties have gained momentum, especially the Alternative for German Party (AfD). The migrant crisis coupled with Germany's need to supplant its aging workforce due to an increased need to promote immigration in Germany has challenged the nation's multiculturalism experiment. Merkel's popularity has waned as a result of the migrant crisis and has tested her resolve as Chancellor. The failure to promote a collective European approach to the migrant crisis in terms of creating an equal distribution of refugee settlement alongside the task of reinforcing both internal and external borders greatly inhibits Germany's ability to promote multiculturalism and integration moving forward.

Migration

As a recipient country during a period of mass migration highly influenced by environmental factors, climate change, and human rights-related crises, Germany over the next decade will continue to experience a phenomenon wherein its migrant and refugee policies will culminate in a transformation of the demographics of Europe. Merkel faces an extreme backlash from the difficult and unpopular decisions she has made in light of the European migrant crisis. In order to rise from the current refugee and migrant predicament as the mass movement further proliferates, the German Chancellor struggles to create a pan-European Asylum policy that receives widespread support.

Foreign Policy

Germany's role on the international stage has increased over the past few years as its geopolitical interests have forced Germany to play a more assertive role in terms of its foreign policy. The shift away from its "culture of restraint" has been

mainly attributed to a number of looming crises occurring both within Germany's borders, such as the Syrian Refugee Crisis, along with crises in its periphery with the Russian annexation of Crimea forcing German condemnation. As the possibility of further Russian aggression becomes more plausible to Germany, Merkel strives to secure the continent's energy security and set new parameters of European geopolitics. But at the same time, the possibility of seeking new alliances in the east and the west to offset Russia while strengthening their own economic policies will have a considerable impact on German foreign policy.

1.3. PATH TO 2026

2016-2017: Continuing Political Fragmentation

Just as European Union leaders arrived at a deal with Turkey to help mitigate the symptoms of the refugee crisis in early 2016, German Chancellor Angela Merkel was confronted with a number of challenges both within her borders and throughout the EU. The 2015 terrorist attacks in Paris, along with an increasing number of attacks in Germany allegedly committed by people from the same migrant populations, have given momentum to right-wing populist groups rallying against Merkel's asylum and immigration policies. The Alternative for Germany Party (AfD) has been sustained by rising dissent over the country's migrant policies, which led to over one million migrants being welcomed into Germany in 2015. AfD's presence extends to half of German state assemblies. The AfD has been an illustration of increasing support for populist parties, with recent polls gathered at the beginning of 2016 placing AfD at a 14 percent approval rating, bestowing new challenges for Angela Merkel ahead of the 2017 elections.

The decrease in support for Merkel goes beyond her policies on migration. The uneven distribution of wealth and discord over Merkel's alleged weakness in asserting a greater influence on ECB economic policies has led to an increase in the amount for support right-wing populist groups such as the AfD party in Germany and the Patriotic Europeans Against the Islamization of the West (PEGIDA) street movements have been founded. As Germans continue to feel polarized in terms of socioeconomic status, income inequality, and rising fears about the threat of terrorism, citizens' discontent with Merkel have begun to support anti-establishment parties; in turn, often channeling grievances in the form of nationalism and anti-immigrant sentiment. Also,

heightened nationalist rhetoric along with an increase in threat perceptions induced by the AfD and PEGIDA led to further traction gained as the European migrant crisis and sectarian conflict in the Middle East protracts.

Meanwhile, Germany, as the main decisive policy player dealing with the European migrant crisis, has advocated for the strengthening of the European Union's border protection agency, Frontex. But given the high number of refugees pouring into the Mediterranean, countries such as Greece and Italy, continue to implement their own national border controls in lieu of accepting support from Frontex. Discord between EU member states over Frontex's role compels Chancellor Merkel to continue to denounce the closing of internal EU borders. The failure to cooperate with Frontex on securing external borders, coupled with a political deadlock in Geneva regarding the Syrian civil war, inadvertently increases the overall number of refugees entering the EU leading into 2017. Apart from the external borders, countries within the Schengen Zone are beginning to employ stringent border policies to control the refugee influx. Austria, for one, has chosen to ramp up plans to create a fence at the Brenner Pass – the passageway between Italy and Austria – to restrict the flow of refugees; Austria continued to maintain that the EU was not doing enough to protect its member states and therefore asserted a need to increase domestic efforts to implement border controls.

Germany under Chancellor Merkel faced a number of other challenges relating to the lack of political cohesion. Dissonance within the EU over the pipeline project known as Nord Stream 2 increases as the project further augments fears throughout the EU. Perceived dependence on Russia for energy compels the European Parliament, along with energy officials from other EU member states, to attack Germany's stance and role in the project. Criticism over previous Russian pipeline projects, namely the South Stream project, causes Southern European states to accuse Germany of hypocrisy and working solely within its own national interests due to its dual stance on projects which are directly beneficial to its own interests. The sharp criticism about EU energy security brings into question the viability of an ever closer union.

2018-2020: Germany Limited as Systems Integrator

The subsequent rise of terrorist groups in the Middle East (e.g. ISIS) and a renewed aggressive stance taken by Russian

President Vladimir Putin towards foreign policy have emphasized a debate in Germany on the plausibility of a collective European defense policy. Chancellor Merkel continues to assert that a European collective defense mechanism will allow the European Union to strategically position itself to take leadership roles in the international community.

Germany's proposal for an EU military continued to face opposition as the European Union member states gathered to vote on it. Especially after the UK's referendum and its diminished involvement in EU affairs, the military was seen as another instrument undermining state sovereignty. In the meantime, Germany continued to argue for a need to complement the existing NATO forces given the extreme sectarian violence taking place in Europe's backyard and the spillover of conflict and refugees into the European Union. Members of the AfD begin to capitalize on Merkel's weak stance on the push for a unified EU military, laying emphasis on Germany's history with true hard power experienced in the previous century. Leading up to the elections, opponents of the Christian Democratic Union (CDU) highlight Merkel's diminishing support base and attack her views on systems integration. The AfD party begins to appeal to groups, which support a more isolationist stance in order to consolidate a larger number of votes. As a result, Merkel finds herself the target of a number of attacks leading up to her bid for re-election. Despite the gains made by opposition parties in Germany due to dissent over Merkel's stance on European asylum policy, Merkel wins re-election by a narrow margin.

In the meantime, after a contentious political battle, Axel Weber was elected the new President of the European Central Bank, increasing the likelihood of tipping EU monetary policies to suit Germany. Within the year, the ECB increased interest rates and eased up on buying back bonds, allowing Germany to increase investment and sustain its position in the global economy. Weber called for an increase in austerity measures amongst member states that were facing an uptick in budget deficit numbers. The ECB's economic policies began disproportionately affecting the smaller and economically weaker EU member states. Greece, Spain, and the Czech Republic felt the economic constraints the most, leading to an increase in dissatisfaction and opposition to Germany specifically. Domestically, the ECB's economic policies begin to alleviate much of the criticism Merkel faced as the German economy begins to grow again.

2021-2023: Failure to Cooperate on Security

Following the failure of talks on the EU military, Germany finds itself enhancing its own sense of national security through cooperative defense. Co-fighting arrangements with a number of its neighbors and various members of NATO provide Germany with proficient military capabilities and the ability to manage resources efficiently so as to not resort to an increase in German military expenditure. But Germany's desire to create a large cooperative framework around defense is not realized. A lack of mutual trust and the fear of smaller EU states being subordinated by a larger state limits Germany's ability to forge partnerships.

After several years of reintroducing temporary border controls across and within the European Union, the Schengen area is no longer in effect and the policy of open borders officially collapses. Irregular migration continues through various parts of the Mediterranean, with countries like Italy and Austria limiting the influx of refugees. The lack of cooperation with Frontex creates worsening conditions for migrants as the smuggling of people across borders intensifies. The lack of coordination on border controls among neighboring states in the EU led to an increase in the number of deaths of people crossing the Mediterranean. Against the backdrop of European Union states renationalizing their borders, Chancellor Merkel looks to Turkey to forge a new partnership to address the continuing influx of migrants and refugees into Europe. Germany proposes to the EU to further increase aid to Turkey and impose a requirement of EU member states to commit to refugee resettlement programs but fails to receive widespread consensus on any long-term solutions as Germany's ambitions are called into question by the EU member states.

As work on Nord Stream 2, the pipeline allowing Germany access to Russian natural gas reserves begins, EU member states as well as the United States grow concerned about Russia wielding undue influence within Eurasia. Since the pipeline has cut Ukraine out of the transfer of energy, causing \$2 billion in losses, the EU grows concerned about repayment of the aid given to Ukraine during its conflict with Russia. In the intervening time, the United States' growing concern about a more aggressive Russia in Ukraine has led to talks with NATO on the need for possible intervention should there be a resurgence of the conflict. Though Merkel maintains her stance on the government's lack of involvement in the pipeline project, foreign criticism of

Germany's shortsightedness goes unabated.

2024-2026: Intergovernmentalism

After enduring years of a massive migration flow, discord among EU states, and a return to nationalism in Europe, Germany's resolve as systems integrator within the European Union has reached an impasse. The success of the 2016 EU-Turkey deal to resettle refugees pouring into Europe was modest at best. The majority of aid provided to Turkey to increase its capacity to withstand a greater refugee population failed to reach the communities to which the funds were allocated. Instead, due to the disinclination among EU states to cooperate on a proper refugee resettlement plan, and in part due to high levels of corruption within the Turkish political establishment, the monetary aid provided had no bearing on the livelihoods of the refugees in Turkey.

Following years of multiculturalism in Germany, immigrant communities failed to integrate. Local leaders were delegated with adhering to the needs of minority and immigrant communities, which led to a compartmentalization of ethnic groups in densely populated areas away from the general population. Refugee resettlement in Germany was unsuccessful in recognizing the impact mass displacement had on refugees gaining asylum. Emotional disorders and post-traumatic stress disorders greatly inhibited the assimilation of most Syrians into Germany, with a large number of economic resources employed for their mental rehabilitation, disagreements over the misallocation of resources continues to grow amongst German nationals. The number of unemployed refugees has increased significantly since many lacked the skills to integrate into the industries that needed skilled workers, relegating them to lower income jobs, which was compounded by the lack of rehabilitation. Due to the unforeseen roadblocks of Syrian refugee integration in Germany, the country experienced a surge in poverty, increased wealth disparities.

By 2025, the AfD had a 30 percent approval rating in Germany. The disenfranchisement of the diminishing middle class in Germany experienced increased perceptions of nationalism and identity formation as immigrants became a target for socio-economic grievances experienced by many. Occasional outbreaks of violence within immigrant communities exasperated the political disconnect between immigrant groups and German citizens. Although by 2025 the European Union and the global

economy at large had begun to experience greater growth and stability, the costs of resettling millions of refugees in Germany exhausted a lot of its economic resources. Meanwhile, Syria became a failed state with various factions in control of the state's territory. The civil war in Syria ended but sectarian conflict only increased the humanitarian crisis in the Middle East region. What was originally believed to be temporary resettlement in Germany became permanent.

Terrorism has remained an enduring threat to peace and prosperity in the EU. As such, border restrictions remain in place, and the number of terrorist attacks committed within and across the regional bloc increased. Anti-immigrant and anti-refugee sentiment surged, while refugees were densely concentrated in southern European states given their geographical proximity to the Mediterranean. Germany, the leading systems integrator in Europe, had failed to develop a pan-European asylum policy to deal with the refugee situation. As a result, millions of refugees were disproportionately settled throughout the EU. Globalization continued to contribute to an era of migration and urbanization. Global population rates increased and the number of migrants and refugees entering Europe became greater than ever before.

1.4. IMPLICATIONS FOR POLICY

This scenario puts Germany at the center of European Integration and the EU project. The renationalization of Germany's neighbors and the shift to intergovernmental models of governance hinder the supranational framework the EU was created under. Germany is in the outer circle in the EU and due to its position on a number of issues, the country caused considerable tensions in the system because it is not a country around which policies coalesce, it is a country which creates policies. Instead of being the integrator, it is more of a decisive policy player.

The direction in which Germany is moving conflicts with the status quo of the international system. Its decision to come out of its reluctant hegemonic role in global affairs is indicative of this shift. As NATO redefines its purpose, from keeping the Russians out and the Germans down, to allowing Germany to play a larger role in this community of collective defense, this leads Germany to view itself as a major player in international politics. The pivot towards Asia in terms of forging strategic partnerships and the opening of Iran, leading to a greater diver-

sification of available energy markets, will give Germany more options and will reduce Germany's reliance on particular countries, including Russia.

As instability in the Middle East protracts and terrorism continues to heighten threat perceptions, multilateral institutions such as the United Nations will struggle to remain relevant. Germany will likely commit to a number of regional arrangements dealing with issues of peace and security. But its current position on a number of issues will shift and participation in global affairs will mature as its capabilities grow, both in terms of its economy and its military. Other countries in the EU, along with the United States, will have to cultivate strong relationships with German leadership to ensure that Germany doesn't become allied with a potential security threat. A China overcoming economic stagnation could lead Germany to invest much of its resources away from many of its Western European counterparts. Also, a European Union under a functionalist model would best serve the regional bloc. Interdependence could mitigate conditions of anarchy and intergovernmentalism while securing key partnerships favorable to European Union states.

It is important to recognize these trends as they unfold. Broadly, policy prescriptions to mitigate the likelihood of the events mentioned in this scenario from unfolding should emphasize interdependence. The EU project was intended to be a model of peace and prosperity. Political cohesion is key to maintaining this. EU member states, as well as the US, should facilitate cooperation among EU states. Key trends in this 21st-century era, namely migration and demographic patterns will prove consequential to the viability of the EU. As such, reaching consensus on refugee resettlement and a common border policy is essential to mitigating risk. Chancellor Merkel will also need to pay closer attention to the incremental changes in the German political establishment. The multiculturalism system, which has not reduced the presence of right-wing populist groups, should be reformulated to promote better integration domestically. The potential for Syrians to feel disenfranchised is great and many are prone to mental health challenges which could culminate in increased vulnerabilities and possible radicalization. Adhering to these policy prescriptions will promote the most favorable outcomes and provide the greatest benefits while mitigating risk.

2. SCENARIO TWO: STRATEGIC RECALIBRATION

2.1. INTRODUCTION

Past grievances over European Union monetary policies lead Germany to expand its scope to Central and Southern Europe. An established hard core allows for Germany to extend its reach as systems integrator while giving it the opportunity to cultivate strategic relationships in order to benefit from the movement of people in an era of mass migration. Investments in infrastructure and transport with countries in the Mediterranean region, as well as with a number of traditional partners in Mittleeuropa (Middle Europe), such as France, Belgium, Netherlands, Luxembourg, the Czech Republic, and Poland allows for Germany to create an enlarged integrationist model. The reduced value of the euro, the British exit from the European Union, an aging population in Germany, along with China experiencing slow growth, forces Germany to search for new partners in order to benefit from new trade partnerships, diversify its energy imports, and promote immigration to compensate for a retiring workforce.

The European migrant crisis has weakened the European Union as a supranational regional bloc. The EU, headquarters in Brussels, have not served the best interests of Germany's growth. Lower than expected growth in China and the United States translate into fewer exports received from countries like Germany, which it is heavily reliant on bolstering growth. The International Monetary Fund (IMF) forecasts suggest that countries in Central, Eastern, and South-Eastern Europe (CESEE) will continue to experience modest growth rates in the coming years, forecasting levels at 3 to 4 percent, but CESEE countries are still crippled by the effects of the 2008 Eurozone crisis, and are experiencing steep declines in working-age populations—a trend expected to continue.⁷ Partially due to global economic stagnation and low oil prices, reports from the European Commission in 2016 forecast growth within the Eurozone to only expand 1.6 percent and 1.8 percent in 2016 and 2017, respectively.⁸ Presumably, economic malaise throughout the rest of the decade within the EU and in other regions of the world will likely maintain low growth rates in the Eurozone.

As developments in European geopolitics leading up to

7 Regional Economic Issues Central, Eastern, and Southeastern Europe: How to Get Back on the Fast Track. International Monetary Fund, 2016. Accessed May 10, 2016. <http://www.imf.org/external/pubs/ft/reo/2016/eur/eng/pdf/reio516.pdf>.

8 "EU Commission sees euro zone growth slowing, urges more investment," Reuters, May 3, 2016, accessed May 10, 2016, <http://www.reuters.com/article/us-economy-eurozone-forecasts-idUSKCN0XUoOo>.

2016 pose great implications for Germany, Chancellor Angela Merkel looks beyond Germany's conventional trade partners. In the wake of the Russian annexation of Crimea and renewed hostilities between Russia and the European Union, Germany drops the Nord Stream 2 pipeline project with Russia. Leadership in Germany then looks for new trade partners in the Pacific, namely Japan, and looks to the opening of Iran's energy market to form strategic trade partnerships within the Eurozone and promote greater energy security. In order to reconcile pressures within the EU to call for increased border protection with the prospective advantages of embracing the influx of refugees, Germany stands at the center of promoting the further integration of the European Union.

2.2. DRIVERS OF THIS SCENARIO

The strategic recalibration scenario emerges due to the effect of the following drivers:

Foreign Policy

With the Eurozone experiencing slow growth, Germany was challenged with exploring new options to adhere to its growing interests. Transformations in the European geopolitical landscape led to strained relations between Germany and Russia, which forced Germany to forge strategic partnerships in order to avoid increased dependence on Russia, while its traditional partners faced internal challenges. The lack of partners with which to work with left Germany to look outward to the South and East to place Germany in a geostrategic position to take advantage of migration flows and cross-border trade around the Mediterranean.

Global Economy

Global economic stagnation led to slow growth rates across many of the world's economies. Lower growth rates in China and the United States compelled Germany to cultivate new geo-economic partnerships to maintain its own growth. With globalization increasing the integration of markets, any of Germany's aggressive economic policies faced a backlash from other economic powers.⁹ In turn, the German economy faced challenges both within and outside of the European Union, mak-

⁹ Ian Talley, "US Chides Five Economic Powers Over Policies," The Wall Street Journal, April 30, 2016, accessed May 10, 2016, <http://www.wsj.com/articles/u-s-warns-five-economic-powers-over-policies-1461960876>.

ing it significantly more difficult to continue to be at the center of the regional bloc.

European Union Integration

The perceived threats of EU disintegration, disagreements over European Union monetary policies, and the lack of consensus to produce a pan-European asylum policy culminated in a weakened ability to robustly deal with the influx of undocumented migrants, while leaving the continent vulnerable to Russian aggression. The failure to deal with rising nationalism and growing populist sentiment throughout Europe inhibited progressive policies that Germany aimed to implement, and left it to expand its integrationist model to fit its national interests while consolidating partnerships into a hard core.

Migration

The renationalization of many nations in Europe and the disinclination to take in migrant and refugee populations led to densely populated migrant hotspots in Southern European countries near the Mediterranean. Germany sought to reap a number of advantages in an era of migration. New partnerships arose with countries around the Mediterranean, as well as with states that serve as transit hubs for migration. Enhancing transportation routes in the Mediterranean for safer cross-border travel helped alleviate the effects of irregular migration.

2.3. PATH TO 2026

2016-2018: Failed Cooperation and Stagnant Economies

Enduring a migrant crisis, the European Union is faced with the challenge of finding a solution to the massive influx of migrants and refugees into the EU. The European Union-Turkey deal to resettle refugees is inhibited by political instability inside Turkey. It later becomes clear that the resettlement of refugees across the European Union will be a long process and will provide no guarantees that a full resettlement plan will follow. EU member states fail to accept asylum applications and continue to enhance national border control protection without coordinating with the EU's border protection agency, Frontex.

Despite the British exit from the European Union, otherwise known as Brexit, which challenged the EU integrationist model, the EU maintains a commitment to the supranational regional bloc. However, economic crises within the Eurozone

impede cooperation. The harsh measures imposed by the IMF and the EU lead to large-scale riots in Greece. Even more troubling are the enduring recession and large youth unemployment rates in Spain indicated a continuing trend of economic malaise. The stagnating economies within the Eurozone leave Germany vulnerable to future shocks and raises fears of other EU member states succumbing to a sovereign debt crisis. Also, economic slowdowns throughout the world began to impact Germany's economy. The beginning of 2017 demonstrated lower German exports to China. Similarly, a number of emerging markets which serve as trading partners for Germany, such as Brazil, also continue to be disparately impacted by slow growth. The prospects of long-term economic stagnation and low growth rates in Germany provoked fears within Germany's leadership and prompted the country to search for new markets.

2019-2021: New Prospects for Growth

Chancellor Merkel and her finance minister recognized that economic malaise experienced in a number of EU member states will make Germany's economy vulnerable. By 2018, Germany understood the impacts economic stagnation had on countries in the Eurozone and came to the conclusion that it needed to gain more flexibility in order to increase its economic potential. Central, Eastern, and South-Eastern Europe (CESEE) countries consistently experienced higher growth rates than many other European countries. Considering the consistent growth trends among CESEE countries, Germany focused a greater share of its exports in this region to support its own growth. Similarly, renewed Russian aggression forced Germany to reconsider its energy security and prompted Germany to strike a number of deals with Iran to explore the prospects of tapping into the Iranian oil market.

As the Syrian civil war ensued and continued to lead to a refugee exodus and spillover into Europe, Germany needed to devise new ways in which the negative impacts of transnational migration could be overcome. By the end of 2018, Southern European countries, such as Italy and Greece, had highly concentrated refugee populations in various urban areas. Its capacity to withstand the refugee influx was at its highest. Chancellor Merkel created a new plan for dealing with the migrant crisis and began coordinating with Italy and Greece to invest in infrastructure and transport to decrease the rate of irregular migration occurring in the Mediterranean. An increased focus on this

region allowed for Germany to coordinate with Frontex to fortify its border controls in the coastal areas and restrict the smuggling of refugees across Southern Europe. In effect, Germany gained access to a number of markets in Sub-Saharan Africa and the Middle East. Forging new partnerships with countries to the South of Germany into the Middle East and North Africa (MENA) became the centerpiece of Germany's future economic prospects. The advantages of facilitating transnational migration became clear. The subsequent increase in the number of migrants entering Europe from the MENA region was welcomed by Germany and began to show signs of compensating for Germany's aging workforce population.

2022-2024: A Vulnerable EU

By the start of the new decade, countries inside the Eurozone have begun to overcome slow growth. A resurging German workforce, along with the addition of new trade partners allowed Germany to assist EU member states in recovering their economies to pre-crisis levels. However, while reforms have mitigated economic crises, the EU remained vulnerable to financial shocks, thus keeping a number of EU member states exposed. But despite Germany's role in assisting countries inside the Eurozone recovery, its political standing has waned following the handling of the European migrant crisis. Additionally, years of resentment towards European Union integration in many countries greatly impeded regional cooperation and coordination. The sectarian conflict in the Middle East that continued to fuel refugee flows into Europe only contributed to EU fragmentation. Ideations around identity and nationalism continued to surge, but early in 2022, after a terrorist attack in Budapest, Hungary, the lack of a regional coordinated response to communicate information between various intelligence agencies led to a second terrorist attack in Prague only days after.

The geopolitical landscape of Europe became increasingly volatile. The threat of Russian aggression due to its deteriorating economy prompted many European nations to diversify their energy imports. But at this point, an unpredictable and volatile Russia had the ability to act unabated. Political fragmentation within the EU, coupled with Germany's formation of a new hard core in parts of Southern, Central, and Eastern Europe, led to a Europe divided into a number of peripheral areas. The last years of disunity within the regional bloc exasperated resentment towards the EU project.

Germany's geo-economic expansion had many unintended consequences. While the country's strategic recalibration of partnerships allowed it to diversify its economy and decrease the risks of experiencing financial shocks, its security has greatly weakened. The country's geo-economic partnerships in MENA and around its periphery in Central, Southern, and Eastern Europe led to divisions within NATO. The disinclination of EU member states to sufficiently cooperate on matters of terrorism and mass migration sowed deep political disconnects. In turn, EU member states within NATO fail to cooperate on a coordinated response to various instances of Russian aggression, leading to the Kremlin engaging in a number of conflicts in Eastern Europe and forcing the United States to take a stronger stance in the region.

2025-2026: European Union in Turmoil

By 2025, the formation of a hard core around Germany's periphery allowed the country to bolster its workforce population and maintain the rate it exports goods. But with Greece continuing to struggle to recover from a previous sovereign debt crisis, coupled with oil prices remaining relatively low, the value of the euro was in decline. Moreover, while Germany was able to increase its workforce population, the refusal of many EU member states to promote immigration along with the renationalization of many of their borders, culminated in a diminished working-age population. The low levels of productivity that resulted eventually led to slower economic growth throughout the EU.

The lack of political cohesion between EU member states became evident to Germany at the end of the year when a call by German leadership to create an EU-wide defense community to protect its borders against terrorism and an unstable Russia was met with wide criticism and dissent. Moreover, the inability to formulate a pan-European asylum policy to promote the resettlement of refugees from the Middle East and North Africa across Europe leaves Germany to deal exclusively with members of its hard core and distance itself from the EU integrationist model. Moreover, the effects of the migrant crisis left Germany, along with Greece, Italy, and Turkey, with extremely large refugee populations. While it remains in the Eurozone and continues to strive to foster cooperation on EU monetary policy, Germany looks to NATO for security and increases its participation in NATO missions.

2.4. IMPLICATIONS FOR POLICY

This scenario presented Germany as a state actor adapting to changing conditions in the EU. The formation of hard cores was driven by Germany's failed attempts at promoting political and geo-economic cohesion in the EU. The ever closer union no longer existed. While Germany realigning itself with Southern, Central, and Eastern European countries to benefit from transnational migration proved successful for its own interests, the hard core it created proved to exasperate an already politically divided Europe. Similarly, the lack of coordination among EU member states only increased their vulnerability to terrorist attacks. While many EU members increased border controls within their states as a means of protection, a failure to share intelligence between states weakened security defense capabilities.

The implications this scenario has on Germany are important in understanding what some of the effects would be if the European Union were to disintegrate. A divided European Union can also translate into a weakened NATO. Consequently, Germany in this scenario is a reflection of a loss of options available to it. Political discord among EU members compromises the viability of the EU project. Moreover, a divided European Union would give rise to Russian aggression and would necessitate a greater US presence in Eastern Europe.

It is also important to highlight the plausible outcomes this scenario reveals. A Germany in the midst of a European Union that is uncooperative and dysfunctional impedes its role as systems integrator. The lack of political cohesion in this scenario demonstrates that whether Germany creates a hard core and provides the EU with new partners in trade or energy or decides to continue to work with traditional partners, the Eurozone will remain vulnerable. For the United States, a Germany that pivots towards new partners could potentially create long-term implications for US trade with the EU or Europe at large. It would also endanger the possibilities of passing the Transatlantic Trade and Investment Partnership. In terms of Germany's foreign policy and trade relations, it is important to recognize what leads Germany's grand strategy. Germany works in pursuit of its own national interests but pursues its interests in a way that allows it to remain at the center of the partnerships it engages in. Likewise, as its economy continues to grow, its interests will evolve, and Germany's participation in international affairs will surely grow.

Considering the drivers that affect German policy, there

should be a solution for the European migrant crisis in order to promote the greatest plausible outcome. A greater emphasis on refugee resettlement, migration flows, irregular migration, and Turkey's role in alleviating some of the systems of the refugee influx is needed. More importantly, European Integration leads to a safer Europe and decreases the likelihood of Russian aggression. European Union disintegration would lead to major shocks in the global economy. To prevent this, the US should assist Germany in promoting the further integration of the EU through additional trade partnerships, the fostering of interdependence, and the promotion of greater participation in NATO. As Germany holds the largest economy in the EU, its influence allows the country to set limits and hold leverage in a number of political affairs. Therefore, it is important for the US to recognize this and maintain a strong relationship with Germany.

3. SCENARIO THREE: EUROPEAN POLITICAL DIVERGENCE

3.1. INTRODUCTION

Following Britain's exit from the European Union, the Czech Republic, Greece, Italy, Austria and Spain all exited from the European Union after holding referendums. The monetary union collapsed forcing Germany to reconsider its monetary and fiscal policies towards other European states as well as other strategic geographical partners. After losing its 27 tariff-free trade partners, Germany's economic prospects caused panic and currency speculation. In order to counter the shocks of the dissolution of the EU, Germany leverages its political position to sign on to Transatlantic Trade and Investment Partnership (TTIP), strategically linking its economy to that of the United States and attempting to forge new Pacific trade partnerships.

The collapse of the EU rendered the Turkey deal concerning the refugees defunct, leaving Germany on its own to deal with the migrant crisis. Merkel's waning ability to control the events that took place within the EU and in the face of the economic crisis causes mass protests calling for her resignation. The Alternative to Germany Party (AfD) seizes this opportunity and places itself strategically to take a larger percentage of the German parliament. AfD's rise causes a surge in nationalist policies, including laws targeting minority and Muslim groups along

with a pullback on the number of refugees it accepts.

AfD also proposes new fiscal policies, lowering the taxes and increasing austerity measures to keep a strict control on inflation, which is in line with historic German economic policies. The Deutsche Bundesbank, though, increases interest rates to give investors greater returns on investments in an attempt to make foreign investment in German banks more attractive. However, this move also inadvertently lowers the capital reserve requirements and increases the amount of money being circulated thereby increasing consumer spending.

In order to strategically balance Russia's geopolitical ambitions with increasing pressure from its newest geo-economic partner, the United States, Germany seeks out Iran as a potential partner to counterbalance Russia. Abandoning its commitments to the Syrian refugees in light of its new ties to Iran, the Syrian refugee project comes to a screeching halt with Germany focusing all its efforts on re-establishing trade ties and rebuilding its economic capabilities.

Germany's policy of Ostpolitik is no longer feasible as Russian aggression deteriorates Russia's relations with the West and concerns relating to energy security forces Germany to pivot to new regions and countries. Consequently, Germany sets its ambitions on collaborating with countries benefitting from migration, such as Turkey, in order to forge geo-economic relationships beneficial to its national interests. Favoring functional geography in terms of supporting countries serving as hubs for industry and migration compels Germany to ally with countries leveraging population flows as currencies of power.

3.2. DRIVERS OF THIS SCENARIO

The European Political Divergence Scenario emerges due to the effect of the following drivers:

European Union Integration

After a British exit from the European Union in 2016, the Czech Republic, Greece, Italy, Austria, and Spain held passed referendums to exit, leading to the disintegration of the EU project. Following the collapse of the single currency, the global market was in complete disarray, leading to shocks in a number of countries. The lack of consensus to robustly deal with the influx of undocumented migrants and flawed EU monetary policies left Germany to deal with the migrant crisis on its own and strive

to recover from the shock in its economy caused by the collapse of the Euro.

Foreign Policy

Following the disintegration of the European Union, Germany sets its ambitions on collaborating with countries benefitting from migration in order to forge geo-economic relationships beneficial to its national interests. Favoring functional geography in terms of supporting countries serving as hubs for industry and migration compels Germany to ally with countries leveraging population flows as currencies of power.

Global Economy

The collapse of the Euro led to a large shock in the global economy. Countries both within the Eurozone and in different regions experienced fluctuations in currencies and stock market crashes. For much of the European Union, including Germany, fiscal and monetary policies were completely reevaluated. New geo-economic partnerships were formed. A worried Germany sought to cultivate new relationships with non-traditional partners. With globalization increasing the integration of markets, any of Germany's aggressive economic policies faced a backlash from other economic powers.¹⁰

Domestic Politics

Against the backdrop of EU disintegration, Chancellor Angela Merkel's ability to make policy prescriptions both within Germany and internationally waned. The lack of political capital to control rising right-wing populist groups led to mass protests. Following the surge in nationalist sentiment, populist groups within Germany's political establishment gained a greater representation in Germany's parliament, called for anti-immigration laws, new fiscal policies, and measures of austerity to gain control over Germany's economy.

3.3. PATH TO 2026

2016-2018: European Union Disintegration

For several years leading up to Brexit, global economic upheaval challenged the European Union's monetary union a number of times. The failure to sufficiently deal with the Euro

¹⁰ Ian Talley, "US Chides Five Economic Powers Over Policies," The Wall Street Journal, April 30, 2016, accessed May 10, 2016, <http://www.wsj.com/articles/u-s-warns-five-economic-powers-over-policies-1461960876>.

as a single currency led to its ultimate demise, leaving Germany to desperately search for new partners. Following Brexit and the subsequent referendums passed by a number of countries to leave the European Union, negotiations ensued for long periods of time to discuss how the EU dissolution affected trade, investment, and currencies. The negotiations, coupled with increasing uncertainty about the viability of state economies, led to disarray in financial markets. For Germany, the EU dissolution halted GDP growth and placed its economy at a standstill. German exports were especially impacted, as workforce productivity dramatically decreased.

The Alternative for Germany Party (AfD) turned Merkel's losses in support into their gains. AfD members in the German Parliament called for Merkel's resignation leading up to the 2017 elections and called for a complete stop to immigration in Germany. Mass protests in the streets of Berlin led to violent attacks against the Syrian refugee population in various areas of the city. The public in Germany expressed outrage over what they believe to have been a mishandling of state expenditure used to provide social welfare for refugees that otherwise would have been allocated towards alleviating symptoms of economic malaise. Under these circumstances, the AfD particularly appealed to disenfranchised populations by denouncing the current state of affairs and went insofar as to call for the deportation of migrants and refugees in Germany.

The collapse of the European free market had great implications in the political sphere. The subsequent collapse of European Institutions left Germany at the end of 2017 with few partners to broker deals with regarding the European migrant crisis. The absence of a sufficient response from European nations to respond to the protracting migrant crisis forced Germany to alter its asylum policies and slow the number of migrants entering its borders. The apparent vulnerability of the German political establishment led Russia to use propaganda messages targeted at Russian populations in Germany to invoke right-wing populist sentiments. Domestic pressures in Germany forced Chancellor Merkel to seek ways to overcome the economic malaise and political quagmire experienced from the regional bloc's disintegration.

2019-2021: In Search of New Partners

Fearing the future of Germany's energy security and dependence on Russia for energy imports, Merkel moved to forge trade

partnerships with Iran, Brazil, and Azerbaijan to secure energy supplies. This trade partnership, fostering economic cooperation, signified a shift in Germany's overall economic strategy. Still, the economic situation in Germany was particularly troubling. Merkel met with the leadership in Washington a number of times to find ways in which Germany could strike new deals with the United States. But the re-emergence of the Deutsche Mark has still left the financial market in Germany in disarray. The protracting negotiations relating to the EU exits are illustrative of the extent to which Germany is limited in its ability to recover its economy.

The absence of partners which Germany can align with on matters of defense and security leaves Germany feeling especially uncomfortable. This feeling of vulnerability leads Germany to strengthen its commitment to NATO by meeting its quota contributions of 2% of overall GDP. Merkel also calls for increased military expenditure and a modernization of the German military. However, she receives harsh criticism in Germany among those who remember the country's past relationship with true hard power. Merkel then opts for a military-sharing economy with some of its neighbors, including the Netherlands, Denmark, Poland, Sweden, Norway, and Finland. Doing so allowed for Germany to save funds allocated for military expenditure for use in other projects, as well as to maintain modest military capabilities providing Germany with security.

With regard to Turkey, Germany leverages Turkey's desire to foster greater trade relationships with Western and Central European states in order to receive renewed commitments by Turkey to NATO. At the same time, in order to bolster security in Germany, Merkel increases military aid to Kurdish groups to assist with fighting terrorist organizations in the Middle East. Also wary of terrorism within its borders, Germany meets with the leadership in Israel in order to train intelligence officers in cyber warfare and ways and means cyber intelligence can be used to combat terrorism and extremism in Europe.

2022-2024: Road to Recovery

The geo-economic partnerships Germany forged in light of the collapse of the Eurozone led Germany's economy to the path to recovery. The government initiated austerity measures on fiscal policies and managed to increase foreign investment and maintain low levels of inflation. But the budget deficit from containing the migrant crisis in lieu of other partners in Europe

besides Turkey took its toll on Germany's economy. Wealth disparities remained high despite an increase in public consumption to bolster exports and unemployment reached double-digit percentages. Germany came to realize that bi-lateral trade partnerships were not enough to allow Germany to recover and return to its pre-crisis levels of economic growth.

The leadership in Germany shifted its focus to the East. Central, Eastern, and South-Eastern Europe (CESEE) countries were the only countries in the region that maintained economic growth rates of 2-3 percent following the EU's dissolution. Germany created new partnerships with CESEE countries and after securing economic relationships with various countries in this bloc, Germany increased its focus on exports in order to meet the demands of these emerging economies. But Germany faced new challenges in light of these new partnerships. Without the European Union to leverage its geo-economic relationship with Russia, Putin engaged in armed conflict in a number of Eastern European countries, causing many CESEE countries in the East to exhaust many of their resources against Russian aggression. Similarly, unlike the EU, high tariffs on trade made it more difficult for Germany to effectively benefit from trade partnerships in the East and therefore impede Germany's path to economic recovery.

2025-2026: Forced to Pivot

After almost ten years of experiencing a series of economic downturns, Germany looks to Eastern and Central Europe to create a new integration project. The German leadership moves to go beyond a geo-economic relationship with CESEE countries and calls for the creation of a regional bloc. Fearing further aggression from Russia, Poland becomes the first to agree to the formation of the supranational bloc. Thereafter, Denmark, Sweden, Norway, and Finland, along with Albania and Kosovo join. The regional bloc, coined as the Extended European Union (EEU), causes widespread criticism from the United States, which then advocates for Germany to increase cooperation with the Western European States.

Looking to maximize its economic potential, Germany pivots to Asia in order to tap into the emerging markets in the region. Utilizing its position with the United States, Germany gains access to economies in the Trans-Pacific Partnership (TPP). With a huge market to engage in trade relations with, Germany produces exports at higher rates, reaching pre-EU

dissolution levels. The strategic trade partnerships built with the East Asian States – including China – and members of the newly formed EEU bloc, allows for Germany to close the year with modest growth rates. Domestic discontent is reduced following the long economic recession and the Christian Democrat Union (CDU) once again gains a majority in the state assembly. With the economy growing, Germany resumes accepting asylum applications and begins settling refugees and migrants in Germany to bolster the workforce population.

3.4. IMPLICATIONS FOR POLICY

This scenario puts into perspective how Germany's historic austerity policies will lead to a considerable number of countries exiting the European Union, essentially rendering the institution defunct. This scenario aimed to force policy-makers to consider a Europe without a European Union and a Germany left without partners. The Extended European Union bloc is but one example of how important regional arrangements are for the mutual economic benefit of European nations, especially Germany.

In order to avoid the worst possible scenario of a European Union dissolution, Germany should make concessions to the European Central Bank as well as to debt-ridden states, such as Greece and Spain. With the United Kingdom out of the EU, in a failed attempt to counterbalance Germany and Merkel's push for EU-wide asylum policies the EU could face the possibility of collapse. In the event that happens, Germany would be left scrambling to renew trade ties or establish new ones, but not before an economic downturn or a possible recession becomes a reality. Germany would also have to reconsider its longstanding emphasis on anti-inflationary policies because there would be a concerted need for economic stimulation. No foreign entity, government or corporation, would risk investing in countries that in such a volatile state, force Germany to eventually give up their austerity policies. Moreover, domestic measures on austerity would be incapable of sustaining its social welfare system if Germany's economy experienced a shock.

Of course, the scenario also highlights the long term effects of Brexit for Germany. Most EU member states look to the British to counterbalance Germany within the institution. In its push for deeper integration and asserting its power at the center of the EU, Germany has found itself resented by smaller EU states. Despite this, Germany surprisingly remains an impedi-

ment to the EU deeper integration project given its reluctance to give up any sovereignty. To show its commitment to the European Union member states, Germany would have to show restraint in its assertion of its position in the EU.

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Transatlantic Relations

6. 1. Brewing Transatlantic Tea: The Future Prospects between NATO and Turkey

SUBMITTED BY

Roger Hilton

ABSTRACT

It is a precarious time to be a spectator when assessing NATO-Turkish relations. From NATO Members scantily supporting the government in Ankara in the wake of a failed summer putsch to Russian President Putin actively courting Turkish President Erdogan to his orbit of interests, the current trajectory between the Alliance and Turkey is alarming. Although the tumult in bi-lateral relations is nothing new, the deteriorating state of transatlantic ties is materializing at the most inopportune moment. In addition to Turkish domestic policies dangerously flirting with compromising NATO founding values, a groundswell of security threats and how to collectively approach them have cemented paralysis in constructive dialogue. Consequently, all efforts to rehabilitate relations must be exhausted as failure to do so would only serve to weaken the transatlantic bond and reinforce NATO's enemies' interests. Against this bleak backdrop, evaluating contemporary transatlantic ties based on the objectives of Turkish internal and foreign policy is critical to gauge the future prospects of transatlantic cooperation. More importantly, it serves to offer a fulcrum for how to mend NATO-Turkish ties. To restore global stability, NATO and Turkey must recognize how each remains indispensable to one another's success to overcome this debilitating impasse.

1. THE CURRENT TRANSATLANTIC POT OF TEA

The relationship between Turkey and NATO is a lot like a pot of tea; it can be served freshly steeped or harshly burnt. Unfortunately, at the moment, this pot of transatlantic tea is bitter. Since the July 15th coup of 2016, relations between the Alliance and Ankara have been less than constructive. This lackluster cooperation is an unwelcome development at a time where both parties should be looking for joint crises solutions. From the resurgence of Russian aggression to the toxic entity known as the Islamic State (IS), there is a groundswell of security issues that require attention. This current divergence is counterproductive and only serves to reinforce the NATO's enemies' interests. Even more worrisome is the lack of momentum for a rapprochement that plays into the hands of Russian President Vladimir Putin's premeditated intentions to sabotage relations. This feature has become more pronounced as President Recep Tayyip Erdogan looks to establish an independent foreign policy posture outside of a transatlantic framework and revive Turkey's Ottoman grandeur. Against this backdrop, NATO and Turkey need to urgently rediscover their respective values to re-solidify ties in order to move past this bleak episode.

In order to assess the future prospects of transatlantic ties, it is necessary to consider a variety of interconnected factors to gauge the overarching situation. These factors include: President Erdogan's domestic ambitions, contextualizing the legacy of NATO-Turkey relations, the impact of Turkish military coups on domestic and foreign policy, and the intentions of Russia to dislodge unity among allies. Only after a comprehensive review of these elements, will an accurate picture emerge. It is my intention to demonstrate the overwhelming utility Turkey possesses for NATO, and why Turkey simultaneously has no suitable alternative to NATO. Underscoring this is the need for the Alliance to shift the disturbing signs of realignment between Moscow and Ankara, which could metastasize if not properly checked. Recognition by both parties of this imperative is critical, as global security is set to be volatile for the foreseeable future. Based on the litany of hazards threatening Turkey as well as other NATO member states, the current pot of status quo must be reversed ruthlessly in order to facilitate more global predictability and reduce hostilities. Continued complacency by Ankara and NATO would only inject more instability and endanger the post-Cold War order.

2. PRESIDENT ERDOGAN'S DOMESTIC AMBITIONS

The tumultuous elements of Turkey's political landscape have always been a feature NATO has had to acclimatize to. Consequently, the ebbs and flows of NATO-Turkish relations is a long-standing phenomenon that dates back to as early as 1960 when Turkey's first military coup took place. While a slew of coups transpired throughout NATO-Turkish relations, the current deterioration is unlike previous experiences. This impasse is distinguished in large part due to President Erdogan Sultan's reign which began well in advance of the attempted putsch. Since 2003, when the former mayor of Istanbul successful ran for Prime Minister under the Justice and Development (AKP) banner, the domestic political landscape in Turkey has been subject to a gradual centralization of power. Such an overt attempt by President Erdogan to consolidate power runs contrary to Turkey's proud history of an independent judiciary and robust political opposition, engrained in the country's 1924 constitution. For a time, these staunchly defended secular principles enabled Turkey to be considered as a political role model for the Arab world to emulate as echoed by Faisal J. Abbas in a commentary for the World Economic Forum in 2012, *"In a post-2011 Arab Spring, Turkey has become even more interesting to examine as the newly-freed Arab countries looked for models of secular states that has managed to balance being a democracy and being Muslim."* How much has changed since this declaration?

Faced with the prospect of being recused from Turkish political life due to a Prime Ministerial term limit, Mr. Erdogan engineered a method to prolong his political tenure. After shifting from Prime Minister to President in August 2014, Mr. Erdogan lobbied aggressively to transform Turkey into an executive presidency to replace the current parliamentary model of governance. Under the auspices of political reform, specifically the need to strengthen decision-making abilities he exploited nationalist rhetoric and populist policies to garner support. Underlining President Erdogan's motivation for this change is his desire to be unshackled from governing with coalitions. This initiative faced gaunt resistance due to his systematic program to erode the political opposition and restrict both mainstream and social media platforms. None more detrimental than the unlawful seizure of Turkey's second largest circulated newspaper Zaman, according

¹ Abbas, Faisal J. "Turkey: A Middle East Role Model | World Economic Forum." June 4, 2012. Accessed October 20, 2016. <https://www.weforum.org/agenda/2012/06/turkey-a-middle-east-role-model/>.

to Yavuz Baydar of the Platform for Independent Journalism, *“The seizure of the news agency following that of Zaman is another nail in the coffin of journalism in Turkey.”*²

Undoubtedly, these unwelcome assaults on democratic principles comprised NATO’s commitment to democracy as outlined in the 1949 Washington Treaty preamble, *“They are determined to safeguard the freedom, common heritage and civilization of their peoples, founded on the principles of democracy, individual liberty and the rule of law.”*³ Such criticism of Turkey would be incomplete without recognizing other NATO members like the Visegrad States of Hungary, Slovakia, the Czech Republic, and Poland, who are simultaneously suffering from a democratic deficit as confirmed by *The Economist*, *“The Visegrad group once aimed to accelerate its members’ integration into the EU. Its turn towards illiberalism presents Europe with a problem.”*⁴ In the face of his alleged authoritarian tendencies, these denouncements have failed to deter President Erdogan, as the construction of a colossal presidential palace on the outskirts of Ankara confirms his defiant attitude.

His personal vendetta to complete this political transformation was on display during the most recent 2015 Turkish general election. Despite the presidential role being politically neutral, when elections were held in June, President Erdogan campaigned aggressively for Prime Minister Ahmet Duvagolu. As Mr. Erdogan’s first Foreign Minister from 2003, it was perceived by outsiders that he backed Mr. Duvagolu due to his ability to be easily dominated and subsequently accepting of the new Presidential system. Unfortunately, the election results were not to the liking of Mr. Erdogan, as the AKP lost its parliamentary majority; a rarity not seen since 2002 that produced a hung parliament. Attempts to form a coalition government within the constitutional limit of 45 days failed with many experts asserting that Mr. Erdogan possessed no real intention of forming a government, a position advocated by John Hannah of the Foundation for Defense of Democracies, *“With the AKP still holding a plurality of seats in parliament, Erdogan designated his successor as prime minister, Ahmet Davutoglu, to lead efforts to form a government within the constitutionally-mandated 45 day period — and then promptly made sure that they failed.”*⁵ The re-run elections were scheduled

2 Letsch, Constanze. “Seizure of newspaper is ‘nail in the coffin of journalism in Turkey.’” March 8, 2016. Accessed October 17, 2016. <https://www.theguardian.com/world/2016/mar/08/seizure-of-news-agency-is-nail-in-coffin-of-journalism-in-turkey>

3 North Atlantic Treaty Organization. “North Atlantic Treaty.” April 4, 1949.

4 *The Economist*. “Big, bad Visegrad.” January 28, 2016. Accessed October 17, 2016.

5 Hannah, John. “Erodgan’s Deadly Ambitions.” September 21, 2015. Accessed October 18, 2016. <http://foreignpolicy.com/2015/09/21/erdogans-deadly-ambitions-turkey-elections-president/>

for November, and President Erdogan leveraged the ongoing regional violence to his advantage, specifically the July decision of the Kurdistan Workers' Party (PKK) to consider a 2013 cease-fire void. Acutely recognizing the slim chances of the opposition, specifically the Peoples' Democratic Party (HDP) retaining their June votes if violence continued, he embarked on a dangerous game of brinkmanship. By allowing violence inside Turkey to spiral out of control, he fostered domestic instability and declared the AKP alone could reinstall security. With campaigning underway, the deadliest terrorist attack in Turkey's history took place in October of 2015 that handed Mr. Erdogan's AKP the majority he had desired. If that was not enough, displeased with the lack of total political subjugation from Prime Minister Duvagolu, in May of 2016 he resigned his post after a series of disagreements and was replaced by a more obedient Binali Yildirim. Omer Taspinar, an expert on Turkey from the Brookings Institution captured this power play relations acutely, *"There is no major ideological divide between the two. It's a power struggle with Erdoğan pushing for total loyalty and full support for his presidential agenda and Duvagolu showing slight resistance to in order to keep checks and balances to protect his role as prime minister."*⁶ Although President Erdoğan had engaged in some suspect behavior and inappropriate tactics to secure his new parliamentary majority in November of 2015 to the dismay of NATO, nobody at the Alliance would welcome the earthquake event that ensued a year later in July of 2016.

3. TURKEY'S FAILED PUTSCH

To describe the July 15th coup attempt as a shock would be an understatement. According to Turkish officials, the Fetullah Terrorist Organization (FETO), led by U.S.-based preacher Fetullah Gulen activated a nesting cell in an attempt to take control of the government while President Erdohan was on vacation. What began at 10 p.m. with an assault on the General Staff Headquarters deteriorated into a chaotic twenty-two-hour marathon of uncertainty. After the bombardment of the Presidential Palace, a missed Presidential assassination attempt, and a sensational address by President Erdogan to the country via mobile phone urging them to take to the streets, the coup was ultimately defeated. By 8 p.m. on July 16th, law and order was restored with Prime Minister Yildirim announcing the 238 (171 civilians,

⁶ Arango, Tim, and Yeginsu, Ceylan. "How Erdogan Moved to Solidify Power by Ousting a Pivotal ..." May 5, 2016. Accessed October 18, 2016. <http://www.nytimes.com/2016/05/06/world/europe/ahmet-davutoglu-turkey-prime-minister.html>.

63 police officers, and 4 soldiers) casualties of the resistance fighters earlier in the afternoon. In a momentous sign of irony, almost exactly twenty-four hours after the attempted coup the Chief Public Prosecutor's Office of Ankara announced the arrest of 2,745 alleged FETO sympathizers and accomplices in a preview of what was to come. The dramatic overreaction in its wake was to be expected according to former NATO Supreme Allied Commander James Stavridis, "*desire for vengeance will be strong*".⁷ In what only conceivable could have been a premeditated purge of civil society,^{10,192} arrests were made while 18,756 people were detained in rapid succession.⁸

In the aftermath of the coup, it is inexcusable that NATO member states did not pledge immediate political backing. This delay and veneer of support would have been costly and exploited by the Kremlin as President Putin was the first foreign leader to reiterate support for Turkey's democratically elected government. Ten days after the failed putsch on July 25th Turkish Foreign Affairs Minister Mevlut Cavusoglu did not mince his words about Ankara's interpretation of international support, "*We have received unconditional support from Russia, unlike other countries.*" This atrophy towards supporting Turkish democracy and the near avoidance of massive loss of human life was especially vitriol from former Swedish Foreign Minister Carl Bildt's perspective, "*When Turkey asked for derogation from the European Convention on Human Rights, EU leaders howled with disapproval, forgetting that France did the same after the November terror attacks in Paris. There is no question that Turkey has the right to, and indeed must, take measures to safeguard itself against forces trying to topple its constitutional order.*"⁹ Although Ankara may be guilty of straying from its democratic bearings, it does not justify the double standards imposed on Turkey. It is worthwhile to consider that if the coup had been successful the country could have been inundated with civil war, not only producing intense violence but motivating Turkish citizens to escape to Europe. This is without even taking into account the uncertain status of the two million Syrian refugees hosted in camps along the Eastern border of Turkey.

Unsurprisingly, the lack of sympathy for Turkey's trauma has produced an avalanche of backlash against the West. It has

7 Stavridis, James. "Turkey and NATO: What Comes Next Is Messy". July 18, 2016. <http://foreignpolicy.com/2016/07/18/turkey-and-nato-what-comes-next-is-messy-coup-erdogan-incirlik-air-base-nuclear-weapons/>

8 Anadolu Agency. "FETO's Coup Attempt in Turkey: A Timeline." August 5, 2016. Pp 6.

9 Bildt, Carl. "Europe, stand up for Erodgan." August 2, 2016. Accessed October 16, 2016. <http://www.politico.eu/article/europe-stand-up-for-erdogan-brussels-greece-coup-european-union/>

even gone as far as to perpetuate wild rumors that the CIA was responsible for the failed coup. With little empathy from the West, President Erdogan has consequently used it as a scapegoat to consolidate even more domestic power. The sum of these developments is music to the ears of President Putin in Russia. With a distinctly distraught position towards the West in Turkey, as well as the cult-like favorability for President Erdogan, the opportunity for the Kremlin to exploit the situation was bound to arrive. Barçın Yinanç wrote in the *Hurriyet Daily News*, “*Contrast the democratic West’s tepid reaction to the failed coup attempt with more supportive reaction from Russia, seen by most in the West as a quasi-dictatorship.*”¹⁰ Amidst this fracture, the burden of responsibility to repair these ties falls on NATO, as failure to do so would not only expose the southern member states to an uncontrollable influx of new migrants but also raise the likelihood of terrorist attack on the continent. What must be reiterated is that this unamicable status does not give President Erdogan an unchecked license to arbitrarily arrest citizens or even re-introduce the death penalty. In these episodes of uncertainty, it is beneficial to remind both NATO and Ankara that this is not the first time domestic strife has gripped Turkey and resulted in the collapse of transatlantic ties. While at the moment these grievances look cemented, both parties should initiate reform through small confidence-building measures, such as intelligence sharing and gradually working their way up to more intensive cooperation.

4. NATO-TURKISH RELATIONS

While it is easy to discharge criticism at Ankara in the wake of its democratic crackdown, it is sometimes overlooked how critical Turkey’s membership is for the Alliance. In addition to Turkey being a long-standing trade and cultural interlocutor between Europe and Asia, its geostrategic territory made it highly sought after for the Alliance according to political geographer Robert Kaplan, “...*Turkey’s position as a land bridge bracketed between the Mediterranean to the south and [the]Black Sea to the north makes it, in part, an island nation*”¹¹ Consequently, as the Cold War began one could hardly blame NATO for wanting to monopolize its strategic value and solidify Western influence. An underlining thrust of this attraction was the strategic balance of power in the Black Sea that tilted in favor of Turkey, based on the Montreux Conven-

¹⁰ Yinanç, Barçın. “European should thank Russia on Turkey.” *Hurriyet Daily News*, September 20, 2016.

¹¹ Kaplan, Robert. *The Revenge of Geography*. New York: Random House Publishing Group, 2012. Pp 285.

tion of 1936 that gave Ankara control over the Bosphorus Straits and the Dardanelles. The ramifications of this were that Turkey regulated the transit of naval warships and provided them with the authority to restrict the passage of naval ships not belonging to Black Sea States.

Post-1945, the Soviet Union through its Ukrainian and Georgian Republics had a near monopoly of ports in the Black Sea in concert with its vassal states of Romania and Bulgaria. This logistic superiority put NATO at a disadvantage in terms of mobilizing resources to the Mediterranean. At the same time, the specter of communism still loomed over Ankara and threatened its secular principles. This was not lost on the West as in 1947, President Truman asked the American Congress to provide aid to Athens and Ankara as letting both states fall to communism was unacceptable, *“The alternative was the loss of Greece and the extension of the Iron Curtain across the eastern Mediterranean. If Greece was lost, Turkey would become [an] untenable outpost in the sea of communism...”*¹² Its approval signaled to Moscow Washington’s cemented commitment to rebuke Soviet influence at all costs that extended further with the creation of NATO in 1949.

After NATO’s inception, both parties acknowledged the utility of cooperation. From the Alliance’s perspective in the event of a dispute with Moscow, with Turkey as a member it could blockade marine traffic through the Bosphorus, rendering Soviet resources to the Mediterranean substantially delayed. Outside of the strategic realm, integrating Turkey into the Alliance allowed it to project influence and power beyond its European Borders that could reach into the Middle East. In parallel Turkey aggressively lobbied for membership, in order to secure financial aid to continue its Europeanization project and modernize its armed forces. Its resolute determination to join the Alliance and combat communism was quickly tested.

In what was the opening act of competing ideologies in the Cold War, on June 25th, 1950 North Korea invaded the South. Fearful of the Soviet Union expanding their influence into Turkish society, the government made a major decision to intervene, *“The Korean War was the first time communists and Western forces engaged in armed combat. The government in Ankara had apparently decided that if war could break out in Asia, perhaps it could happen elsewhere, and it would need a security guarantee if it was going to continue to allow*

¹² Truman, Harry S. Volume II - Memoirs, Years of Trial and Hope. New York: Doubleday & Co, Garden City, 1956. Pp 100-101.

*America to increase its military presence.*¹³ In response to the United Nations' Resolution 83, in July the government sent a brigade of 5,000 troops to fight with the UN Command against North Korea who was receiving material and financial support from the People's Republic of China. Their involvement in the Korean War would prove paramount for their eventual entry into NATO.

Turkey's contributions did not go unnoticed by policymakers in Washington. Under the leadership of American Ambassador George McGhee, Turkey as well as Greece was part of the first wave of NATO enlargement in 1952 that notably predated West Germany's accession in 1955. The merits for Turkish membership were derived both from its strategic and military advantages. From a defense perspective, the Southeastern flank of NATO would be protected against hostile forces where Soviet aggression could be further contained. This would specifically help buffer Soviet expansionary intentions into the Middle East, and allow for more western control of oil supplies. To solidify this position, Turkish airfields that could be utilized for intelligence gathering or if necessary bombing sorties were made available. In terms of sheer manpower, twenty-two Turkish divisions constituted a massive contribution to NATO's deterrence force.¹⁴ Additionally, Turkey drew Soviet resources away from Europe as the presence of NATO forces along its southern border forced Moscow to commit to its protection. When reflecting on these issues in the post-Cold War security environment, it is clear Turkey's addition represented a watershed moment for the Alliance as their commitment to anti-communism was unparalleled.

To contextualize Turkey's ardor, one only needs to evaluate its Cold War suspiciousness towards its Eastern neighbor. In 1957 when its adversary Syria began steeling itself to the Soviet Union, Turkey suggested a military operation in order to secure a more subordinate regime in Damascus, *"U.S. diplomats nixed the plan, explaining that while they admired Turkey's anti-communist zeal, there was no need to alienate the Arab world with an outright invasion when they could just continue discreetly plotting coups instead."*¹⁵ Fast forward to November 2015, and this ruthlessness to defend its interests endures. Throughout the Syrian Civil War, Russia

13 Holmes, Amy Austin. *Social Unrest and American Military Bases in Turkey and Germany Since 1945*. Cambridge: Cambridge University Press, May 2014. Pp 49.

14 Uslu, Nasuh. *The Turkish-American Relationship Between 1947 and 2003: The History of a Distinctive Alliance*. New York: Nova Science Publishers, August 2003. Pp 91.

15 Danforth, Nick. "A Short History of Turkish Threats to Invade Syria." July 31, 2015. Accessed on October 20, 2016. http://foreignpolicy.com/2015/07/31/a-short-history-of-turkish-threats-to-invade-syria-from-1937-to-1998/?utm_content=buffer8fb2&utm_medium=social&utm_source=facebook.com&utm_campaign=buffer

repeatedly violated Turkish airspace and rejected numerous diplomatic complaints and warnings. On November 24th, Ankara's patience proved exhausted as a Turkish F-16 destroyed a Russian Su-24 after it had violated Turkish airspace for 17 seconds despite being notified to change its course 10 times before finally entering the airspace. The crystallization of these events was on replay throughout Russian state media, leading to an apoplectic reaction from President Putin, "*Our military is doing heroic work against terrorism ... But the loss today is a stab in the back, carried out by the accomplices of terrorists. I can't describe it in any other way.*"¹⁶ In response American President, Barack Obama reiterated Turkey's international right to defend its airspace, while simultaneously calling on both parties to avoid unnecessary conflict. While escalation is never desired, it should be noted that Turkey held a red line against continuous Russian violation of its airspace – a position that differs greatly from that of NATO's Baltic air-policing mission which has tolerated numerous violations by Russia against the Baltic States.

Outside of their confidence to engage, Ankara is the Alliance's second largest troops contributor that exceeds a million soldiers when combining active and reserve personnel. When discussing NATO and Turkey any survey would be incomplete without the Incirlik Airbase. It is the crux of the relationship and provides a platform for reconnaissance missions as well as being a training site for air-to-air and air-to-ground missile testing. Throughout NATO's intervention in Afghanistan, it served as the primary command hub to support the war. Additionally, the standing headquarters of Incirlik's Allied Land Command is situated in Izmir, which serves to ensure the interoperability of NATO land forces and is responsible for providing a deployable land command for a joint operation. It represents NATO's largest installation in Turkey.

In terms of a military weapons system, the NATO-mandated Patriot missile defense system is installed in southern Turkey and is designed to deter any threat against member states. It should be recognized this system is not without shortcoming as it failed to shoot down numerous missiles fired from Syria throughout 2016. To complement its Patriot missiles it hosts an early-warning Ballistic Missile Defence radar system in Kürecik. Turkey has also pledged to be the "framework nation" for NA-

¹⁶ Shaheen, Kareem and Walker, Shaun. "Putin condemns Turkey after Russian warplane downed near Syrian border." November 24, 2015. Accessed October 20, 2016. <https://www.theguardian.com/world/2015/nov/24/turkey-shoots-down-jet-near-border-with-syria>

TO's Very High Readiness Joint Task Force (VJTF) by 2021.¹⁷

In the realm of non-European theaters Ankara has provided diverse material support to every NATO mission: the Balkans, Afghanistan, Libya, Syria, and counterpiracy missions along the Horn of Africa. Within Afghanistan, Turkey was tasked with providing security in Kabul and was the third largest contingent within the International Security Assistance Force (ISAF). After the drawing down of the ISAF mission, Turkey was charged with the Train Advise Assist Command – Capital, the multinational military formation of the Resolute Support Mission. On the humanitarian level, Turkey through Incirlik Airbase played a pivotal role in facilitating relief operations after the 2005 Kashmir earthquake. Based on its longstanding contributions in a variety of fields, it is irrefutable that Turkey's presence in NATO is robust, which makes the current state of affairs even more painful given the urgent need to cooperate.

5. TURKISH MILITARY COUPS

For much of Turkey's modern history, the military has possessed a major influence over the governance of political affairs. This responsibility was decreed in 1923 by Mustafa Kemal to intervene to protect Turkey's secular principles, *"The Turkish army has long scrupulously observed the admonition of the late great Kemal Ataturk that the army should stay out of partisan politics. But it also remembered that Ataturk charged it with guarding the constitution."*¹⁸ As history has confirmed, their lack of hesitation to intervene would be a reoccurring phenomenon for NATO to accommodate. In tota, there have been seven interventions by the military that produced varying results.

Beginning in 1960, Prime Minister Adnan Mederes was undertaking a program to de-westernize Turkey and erode Ataturk's reforms. Against a backdrop of social dysfunction and economic turmoil, Colonel Alparslan Türkes assumed control and tried Prime Minister Menderes as well as President Celâl Bayar for treason. Consequently, General Cemal Gursel assumed both positions until 1961, when a civilian government was restored. A persistently weak economy, specifically inflation and a painful recession motivated the military to intervene in 1971 as a "coup by memorandum". In an audacious move, the Chief

¹⁷ Erkus, Sevil. "Turkey offers to take lead in NATO's rapid reaction forces." *Hurriyet Daily News*, May 20, 2015.

¹⁸ Rothman, Lily. "A Short History of Turkey's Modern Military Coups." July 15, 2016. Accessed October 19, 2016. <http://time.com/4408850/turkey-coup-history/>

of the General Staff Memduh Tagmac issued a memorandum to Prime Minister Suleyman Demirel who demanded government policies that better reflected Ataturk's political design. Prime Minister Demirel's failure to do so resulted in his resignation and the ascension of Ismail Nihat Erim. Despite creating a mixed government of civilian and military personnel, the emergence of the Turkish People's Liberation Army marked a dark period and the installment of martial law. In an effort to stem this chaos, retired Admiral Fahri Korutürk was appointed president.

Admiral Korutürk's tenureship is significant as he presided over the 1974 July invasion of Cyprus. This moment would represent the lowest point in relations between Turkey and NATO's members. In addition to the amplification of animosity in Greco-Turkish relations following the invasion, in 1975 Ankara abruptly announced that all U.S. military bases throughout Turkey would be closed.¹⁹The provocative policy was in response to Washington's arms embargo on Ankara after American equipment was used during the invasion. Consequently, only the Incirlik and Izmir Air Bases remained open due to their NATO responsibilities.

After more disappointing civilian leadership, in 1979 the military believed they needed to intervene to restore the rule of law after conflicts between the left and right wing parties had reached a tipping point. In September of 1980 General Kenan Evren, in concert with the National Security Council, abolished Parliament and subsequently banned all political parties. Unconvinced of the functionality of the constitution, they adopted a new constitution that included clauses to ensure the smooth implementation of democratic principles. General Evren was appointed as President and served unopposed for seven years.

A brief lull in political stability in Turkey lasted until 1997. Once again, the Turkish military through the issuing of a memorandum forced the resignation of Necmettin Erbakan of the Islamic Welfare Party. In response, Mesut Yilmaz of the ANAP was tasked with forming a new coalition government with the sitting parliament. A year later the Constitutional Court of Turkey sanctioned the closure of the Welfare Party on the grounds of violating the constitution's separation of religion and State clause. The Welfare Party re-merged through the Virtue Party. What should not be overlooked throughout this entire episode was the prominent role of the then Istanbul Mayor Recep Tayyip

¹⁹ F. Stephen Labarre. "Troubled Partnership: U.S.-Turkish Relations in an Era of Global Geopolitical Change." The RAND Corporation, 2010. Pp

Erdogan who was given a five-year suspension from politics and served a ten-month prison sentence after he read Islamic poems at a public function. The increasingly active role of political Islam in Turkish society subsequently led to the Constitutional Court disbanding the Virtue Party in 2001. Although still officially serving his suspension from politics Erdogan created the AKP who today have a near monopoly over Turkish politics.

In 2007, with presidential elections approaching, Abdullah Gül was positioned to win which was not well received by the military because of his strong affiliation with Islam. Due to the presidential office being considered the custodian of the country's secular values, the military posted an ultimatum on its website to the ruling AKP party not to support Gül's presidency. Although the military was never mobilized, the results had little effect as Gül won the Presidency and served until 2014. The military's dislike for the AKP was again on display through the publicized "sledgehammer conspiracy". Amidst some circulating rumors alleging a military plot to overthrow the AKP government dating back to 2003, in 2012 there were sweeping arrests of military officials. Formally 300 officers were convicted, but in 2014 Turkey's highest court deemed the initial convictions flawed and ordered a retrial. A year later the suspects were cleared of all charges. Against the backdrop of these experiences, NATO should consider themselves extremely fortunate that a similar result did not transpire in 2016. If transatlantic ties have survived this turmoil no doubt they can overcome the current stalemate.

6. TURKISH-RUSSIA RELATIONS

Investing any credibility towards a long-term strategic partnership between Russia and Turkey as an alternative to NATO is a farcical proposition. In the annals of history, the titanic rivalry between the Ottoman Empire and Tsarist Russia has been a long-standing competition where Russia has been the author of much of Turkey's pain. Since the two became neighbors in the mid-15th-century war has broken out 17 times at the behest of Russia with Turkey losing every conflict. During the 20th century, an important moment that defined relations between two the states occurred at the nascent start of the Cold War during the Turkish Straits Crisis. Between 1946 and 1953 the Soviet Union applied great pressure on Turkey to allow it unfettered naval access to the Black Sea.²⁰ Ankara's persistent resistance to Mos-

²⁰ Unver, Akin. "Ankara to the Black Sea." May 12, 2014. Accessed October 17, 2016. <https://www.foreignaf>

cow's demands coupled with Washington's desire not to have the Straits fall into Soviet control pushed Ankara into NATO. Despite this ingrained fear, a burgeoning relationship between President Putin and President Erdogan has developed.

When President Erdogan looks in the mirror, it is easy to see the reflection to a degree of his Russian counterpart. Cengiz Aktar of Istanbul's Bahcesehir University confirmed the similarities, *"He wants a presidential system without checks and balances. It would be the Putinization of Turkey."*²¹ Both leaders ascended to power within two years of each other in the early 2000's, with great ambitions to restore the international status of their states. Throughout this process both have expressed a suspicion of American primacy abroad, while cultivating a populist anti-Western narrative at home. In both cases, the opposition has been reduced and the media state-controlled allowing them to lead indefinitely and unopposed. Outside of consolidating domestic power, the fulcrum of their pragmatic bilateralism has centered on economic and trade cooperation according to Ahmet Han of the German Marshall Fund, *"Over the last decade, Turkey and Russia had developed a tacit and functioning agreement to compartmentalize their relations, separating geostrategic disagreements and economic strategic interests."*²² This economic partnership had led to increased development in four main sectors; tourism, agricultural products, construction projects, and as energy.

Turkey is one of few countries that does not require Russian citizens to obtain visas before visiting. Consequently, Russia makes up Turkey's second largest tourist market and is critical to their resort industry. An estimated 3.3 million Russians visited Turkey in 2014. With this sector being so heavily reliant on Russia, Turkey's decision to shoot down its Su-24 had economic consequences with President Putin signing a decree prohibiting all package holidays to Turkey. After Western sanctions were imposed on Russia for the Crimean annexation, Turkey was given a golden opportunity to supply Russia with agricultural products. Unsurprisingly this cooperation was caught in the crossfire of the jet incident as the Kremlin banned all imports from Turkey which according to the Renaissance Capital in 2014 was worth \$6 billion to the Turkish economy.²³ In the area of

fairs.com/articles/russian-federation/2014-05-12/ankara-black-sea

21 Schliefer, Yigal. "The New Sultan of Turkey." April 22, 2015. Accessed October 18, 2016. http://www.slate.com/articles/news_and_politics/moment/2015/04/recep_tayyip_erdogan_is_turning_turkey_into_an_authoritarian_power_will.html

22 Ahmet K. Han. "Pride and Pragmatism: Turkish-Russian Relations after the Su-24M Incident." The German Marshall Fund of the United States: On Turkey, January 20, 2016. Pp 1.

23 Winning, Alexander. "Turkish firms in Russia struggle as diplomatic row rages." March 30, 2016. Accessed

construction, Russia's state-owned Rosatom was commissioned in 2013 to build four 1,200 megawatt nuclear reactors worth \$20 billion with the first plant in Akkuyu scheduled to be operational in 2022. Across the border, since Turkey entered the Russian market in 1988, 1941 projects have been completed worth an estimated \$65 billion. To date, Turkey constitutes the second largest construction market share in Russia that is only surpassed by China.

Without comparison, the most lucrative part of this economic pact is the energy sector, specifically Turkey's reliable consumption of Russian natural gas. Where this relation becomes more ambitious is with the proposed TurkStream natural gas pipeline that was initially announced in December of 2014. The creation of this project is geopolitically significant as the delivery of gas to Europe from Russia would circumvent Ukraine and by product starve Kyiv of much-needed transit fees, and increase the Kremlin's influence. Despite the recent unpredictability between Ankara and Moscow, on the sidelines of the World Energy Council Congress in October of 2016, both presidents announced the signing of this project. The construction of the project was scheduled to be finished by 2019 but was delayed due to the break in relations over the jet incident. When operational it will also provide discounted gas prices to Turkey. This collaboration speaks volumes according to Turkish political scientist Gökhan Bacik's interpretation of bilateral ties, "*Turkey and Russia have tried a special model of relations in the post-Cold War that is called an "economic first" paradigm.*"²⁴ It should be noted that the cooperation has also extended into the cultural realm. In September of 2015, President Putin inaugurated Moscow's largest mosque, which was attended by President Erdogan and Kazakhstan's Nursultan Nazarbayev, who both provided financing for the project.²⁵ Consequently, the economic and social optics have played well for both leaders.

In the area of national military doctrine, one dangerous overlapping similarity that should be not be discounted is the increasing harmony on policy towards the protection of ethnic nationals outside of state borders. Beginning in 2014, following the Maidan uprising in Ukraine, the Kremlin crafted a position asserting that Moscow reserved the right to intervene using the

October 18, 2016. <http://www.reuters.com/article/us-russia-turkey-business-idUSKCN0WW0EK>

24 Gökhan Bacik. "Turkey and Russia's Proxy War and the Kurds." The German Marshall Fund of the United States: On Turkey, January 2016. Pp 2.

25 Reuters. "Putin opens Moscow's largest mosque, warns against extremism." September 23, 2015. Accessed October 17, 2016. <http://www.reuters.com/article/us-russia-mosque-idUSKCN0RN1UD20150923>

military in order to protect the rights of ethnic Russians facing persecution outside the Russian Federation. This threat of harassment provided a facade of justification to intervene to ensure their security. This blanket assertion would theoretically include the Baltic States, Moldova's Transdniester enclave, and parts of Northern Kazakhstan. This concept has extended to Turkey and is being replicated by President Erdogan as operations to retake Mosul in Northern Iraq are underway. Speaking to an audience in Ankara, President Erdogan declared his concern for "*Our Sunni brothers, our Turkmen brothers*" against the backdrop of potential sectarian escalation with Shia militiamen.²⁶ This ambiguous commentary is a startling development within Turkish foreign policy as it potentially risks dragging NATO into ethnic conflicts without justification, which should be avoided at all costs.

Although the deterioration of relations between Moscow and Ankara was publically smoothed over after the November shoot down, there exists an underlying matrix of foreign policy disagreements that puts a low ceiling on cooperation. Beginning in 2014 with the shock annexation of Crimea, Ankara harshly condemned the action, reiterating the government would never recognize its occupation. Undoubtedly, the seizure of the peninsula invokes sensitive memories, as its ownership has shifted multiple times with the first Russian annexation coming in 1784 against the Ottoman Empire, "*But from the Turkish perspective, Russia's invasion of Crimea fits a 340-year pattern.*"²⁷ Despite this fury, what was less reported was Turkey's opportunistic stealth decision to shun a chorus of Western States to apply sanctions that even permitted flights to Simferopol via Turkish Airlines.

On a cultural level, Russia's annexation produced discriminative policies like those of Joseph Stalin's Sürgünlik policy towards the indigenous Tatar population. In April of 2016, a Russian court determined that the Mejlis, the executive council of the Tatars, was an extremist organization and banned it from operating. The oppression of the Tatars' culture is a sensitive issue in Ankara who considers them as descendants of the Turkic khanates, "*Of course, Russian sovereignty there never stopped Turkey from feeling tied to Crimea... It produced the founding fathers of modern Turkish nationalism, including Yusuf Akçura and Ismail Gasprinski. For*

26 Danforth, Nick. "Turkey's New Maps Are Reclaiming The Ottoman Empire." October 23, 2016. Accessed October 27, 2016. http://foreignpolicy.com/2016/10/23/turkeys-religious-nationalists-want-ottoman-borders-iraq-erdogan/?utm_content=buffer4d3f2&utm_medium=social&utm_source=facebook.com&utm_campaign=buffer

27 Unver, Akin. "Ankara to the Black Sea." May 12, 2014. Accessed October 17, 2016. <https://www.foreignaffairs.com/articles/russian-federation/2014-05-12/ankara-black-sea>

*Turkey, though, Crimea held more than cultural importance.*²⁸ After Russia's High Court rejected the appeal against the ban Turkish Foreign Ministry spokesman Tanju Bilgic expressed Ankara's disbelief, *"It's saddening that the Crimean Tatars, who always express their legitimate demands through democratic and peaceful means, who have no aims other than living a peaceful, safe life in which they are able to express themselves freely, have been suppressed with such methods, reflecting a collective punishment mentality."*²⁹ Today the situation remains unresolved and the Tatars are still persecuted and arbitrarily harassed.

An ever present issue between the two states has been the strategic balance of power in the Black Sea. As established earlier, Russia has sought to minimize the difficulty of entering via the Turkish Straits. Despite the courtship and the contributions of the Organization of the Black Sea Economic Cooperation this issue still haunts the Kremlin. The opportunity to reconfigure the balance arose with Crimea's annexation when it was announced that the Kremlin planned to *"fully utilize the geostrategic potential of Crimea"*. Russia subsequently went about initiating a major buildup of military infrastructure that included the installation of cruise and surface-to-air missiles, and bombers capable of being retrofitted to carry nuclear weapons. The militarization was frightening according to former NATO Supreme Allied Commander General Philip Breedlove, as it essentially transformed the peninsula into another Kaliningrad through the creation of an *"anti-access, area denial"* (A2/AD) system.³⁰ This changing balance of power could not have arrived at a worse time for Ankara, as in 2013 they canceled the National Warship Project that entailed the overdue modernization of its navy.³¹ Consequently, Turkey has no reassuring plan independent of NATO to counter Russia's expansion of the Black Sea Fleet in the event Moscow raises the escalation threshold.

Another fault line between the two that cannot be disregarded is Russia's interference in the affairs of the South Caucasus states. In 2008, it was undoubtedly a disconcerting phenomenon to view Russia invade Georgia and come within 50 km of Tbilisi. Even more startling for Ankara, is the occupation of South

28 Unver, Akin. "Ankara to the Black Sea." May 12, 2014. Accessed October 17, 2016. <https://www.foreignaffairs.com/articles/russian-federation/2014-05-12/ankara-black-sea>

29 Urguli, Sibel. "Turkey blasts Russia's continued ban on Crimean Mejlis." October 3, 2016. Accessed on October 18, 2016. <http://aa.com.tr/en/politics/turkey-blasts-russias-continued-ban-on-crimean-mejlis/657498>

30 Gramer, Robbie. "Changing Tides: Russia's Growing Stronghold in the Black Sea." February 8, 2016. October 19, 2016. <https://www.foreignaffairs.com/articles/russian-federation/2016-02-08/changing-tides>

31 Unver, Akin. "Ankara to the Black Sea." May 12, 2014. Accessed October 17, 2016. <https://www.foreignaffairs.com/articles/russian-federation/2014-05-12/ankara-black-sea>

Ossetia and Abkhazia as well as the continued creeping annexation of these territories. Where regional divergences explode, it is due to the hostile relationship between Armenia-Azerbaijan, specifically the unresolved Nagorno-Karabakh situation. To support the government in Baku, since 1993 as a sign of protest the Turkish-Armenian border has remained closed. Further cementing unamicable ties with Yerevan is President Erdoğan's unshakeable policy towards ever recognizing the alleged Armenian genocide of World War I. In contrast, Russia provides a security guarantee to Armenia to ensure it is not overrun by Azeri military superiority. The recent uptick in hostilities across the Nagorno-Karabakh line of contact in April, known as the "Four Day War" no doubt puts Moscow in an uncomfortable position in the event hostilities that amplify.

It is clear that the labyrinth of relations between Ankara and Moscow is complicated and subject to impromptu moments of disagreement. More importantly, there is nothing to suggest that ties will change beyond what they are now. Based on the evidence, when reduced it could be inferred that the weight of economic interests temporarily outweighs the cascade of disagreements, which could be scuttled at any moment. For the time being it appears that both President Putin and President Erdoğan will be walking a fine line between joint cooperation and defending their respective national interests.

7. STRATEGIC OUTCOMES

When speculating on the future of transatlantic ties between NATO and Turkey, those who believe that the current tumult in relations cannot be overcome are greatly ill-advised. Against this backdrop, it is necessary for NATO to seek out a more conciliatory tone while simultaneously defending the rule of law, an exceptionally daunting political exercise. The Alliance must also remain vigilant and defend itself against Russian "Active Measure" tactics with regards to Turkey. Based on the above-mentioned historical facts and the current state of geopolitics, Turkey's transatlantic future can develop in three ways; the prolonged extension of the status quo, a drastic drift towards the Kremlin's sphere of influence, and finally the suspension or expulsion of Turkey from the Alliance.

Scenario one, the stalemate in relations appears set to continue as at the moment the atmosphere both at NATO and in Turkey is not yet conducive to a rapprochement. With anti-West-

ern sentiment at a pinnacle in Turkey, there is no motivation for President Erdogan to engage NATO and alter his domestic narrative. Compounding the task of mending ties is the disbelief within Turkey at the lack of Western sympathy towards their national trauma. Instead of concentrating on the triumph of the people's will, Western leaders have primarily concentrated on the purges after the coup and its threat to democratic principles. This, in turn, has been interpreted in Turkey as another example of Western lecturing that reinforces their perception as unequal members. Diverging views intensify when it comes to America providing support to the Kurdish People's Protection Unit (YPG), who Ankara considers an extension of the PKK. Ankara's frustration with this support was expressed by Foreign Minister Mevlut Cavusoglu, *"It is unacceptable that an ally country is using the YPG insignia. We reacted to it. It is impossible to accept it. This is a double standard and hypocrisy."*³² Another issue of contention, specifically between Washington and Ankara is the extradition of Fetullah Gulen from Pennsylvania. Turkish authorities are crafting this into a binary decision, *"Sooner or later the United States of America will make a choice. Either Turkey or FETO."*³³

From the Western perspective, there is still much displeasure with the post-coup reorganization of Turkish society, specifically the assault on the rule of law through the judiciary as well as on the lack of opposition media. This policy continues to compromise the founding principles of the Alliance which NATO is ardent in protecting as echoed by American Secretary of State John Kerry in July of 2016, *"NATO also has a requirement with respect to democracy"*.³⁴ Consequently, this stalemate will only allow for the continuation of selective cooperation, like NATO access to the Incirlik airbase. One angle not to discount is the pragmatism of President Erdogan to reach out to NATO when desperate and no alternatives exist. This flexibility was on display with his apology letter to President Putin when tourist sanctions were devastating the Turkish economy, as well as with the restoration of diplomatic ties with Israel after a six-year hiatus.

Scenario two, Turkish strategic realignment with Russia while remaining a NATO member, seems to be in a light stage

32 Hurriyet Daily News. "US soldiers with YPG insignias unacceptable, says Turkish FM." May 27, 2016. Accessed October 19, 2016. <http://www.hurriyetdailynews.com/us-soldiers-with-ypg-insignias-unacceptable-says-turkish-fm.aspx?pageID=238&nID=99734&NewsCatID=510>

33 Avci, Esra Kaymak. "President Erdogan says US must choose: 'FETO or Turkey.'" August 11, 2016. Accessed October 18, 2016. <http://aa.com.tr/en/politics/president-erdogan-says-us-must-choose-feto-or-turkey/626451>

34 Morello, Carol. "Kerry urges Turkey to maintain democratic principles after coup attempt." The Washington Post, July 18, 2016.

of animation. Closer bilateral relations between Ankara and Moscow serve each leader with a public relations tool to advance their respective positions. President Erdogan leverages his intimate relationship with President Putin to voice his frustration and garner more concessions from the Alliance, while the Kremlin preaches its cooperation with Turkey as a tangible sign of its diverse partnerships and growing economic networks. In theory, this chemistry is logical as both consider themselves heirs to rising powers with a right to cultivate major international decisions. They also share an inherent belief of overreach by the Western-led order and are trying to inject more polarity to the current international system. In hard terms, with Western sanctions biting and potentially subject to intensification after Russia's Dresden-like bombing of Aleppo, the economy is starved of activity and needs Turkey as a paltry subsidy to the European Union. Despite the recent public relations blitz between both Presidents, a litany of fault lines will not stretch the compartmentalization beyond economic relations.

If President Erdogan does embark on this path with the Kremlin he should use extreme caution according to Eugene Kogan of the Foundation for Strategic and International Studies, *"The chill in bilateral relations demonstrated that Turkey is more dependent on Russia than vice versa. The so-called strategic partnership between Turkey and Russia coined by some Turkish analysts and commentators never really existed but was rather a Turkish vision without strategic backup that failed the first test of worsening relations between the two countries. The recent rapprochement produced a clear winner in the clash of personalities, namely Putin, while Erdogan was cornered without a chance for escape."*³⁵ Although President Erdogan is pronged to playing with fire with regards to his foreign policy ambitions, it is only a matter of time before Russian action becomes too miscreant, forcing Turkey to pivot back to NATO's orbit.

Scenario three, the suspension or expulsion of Turkey from the Alliance is the least likely option to manifest. If only begrudgingly, Ankara recognizes that it needs NATO and the protection of Article V and would be ludicrous to voluntarily leave. Despite Turkey at times being a convenient Atlanticist, there is simply no alternative prospect that could replace the Alliance. Although Ankara has pursued a diversified foreign policy and made inroads with China, specifically through the Asian Invest-

35 Kogan, Eugene. "Russia- Turkey Relations: Rapprochement on Russian Terms." August 31, 2016. Accessed October 21, 2016. <http://www.defensenews.com/articles/russia-turkey-relations-rapprochement-on-russian-terms>

ment Infrastructure Bank and the One Belt, One Road initiative, it is not enough to supplant the advantages of being a NATO member. If in the unlikely situation President Erdogan decides to terminate transatlantic ties, he should not forget a Turkish proverb that states, “*A liar’s candle will last till evening*”, when steering his country towards President Putin.

8. A FRESH TRANSATLANTIC POT OF TEA

The tragic state of transatlantic affairs between Turkey and NATO should have never been allowed to happen. While both parties are indirectly culpable of this downturn, constructive initiatives must replace accusatory tones in order to cultivate reform. The stagnation of relations is not new and both should take solace in reflecting that in every instance differences have been overcome. This situation should prove no different. Consequently, based on the current geopolitical factors and interests, any chance of a diplomatic breakthrough will likely materialize from one side demonstrating regret in a very public manner. Based on the personal profile and hubris of President Erdogan it seems beyond possible that he will be the first to admit fault. Against this backdrop, as painful as it is for NATO to swallow, they must accept this fact and look towards a strategy of rehabilitation even if that means appealing to President Erdogan’s ego. More critically, they must not lose track of the bigger geopolitical picture, as every second they delay based on pride only enriches the relationship between President Putin and his Turkish counterpart.

Turkey emphatically still belongs in NATO despite its current political transgressions. Gonul Tol the Director of the Center for Turkish Studies and Middle East Institute in Washington makes a compelling case for why the Alliance should not give up on Ankara, “*Yet the psychological dimension of Turkey’s NATO membership has anchored the country the country to the West and provided an important source of leverage for NATO countries. That leverage is even greater today.*”³⁶ While at times it is a flummoxing process to deal with Turkey, the Alliance must make it beyond clear that it values Turkey’s membership. It must follow up this declaration with a comprehensive and rational argument why relations need to be to the advantages of both, and most critically communicated to the Turkish political elite. After such extensive consultations, Ankara will come to the conclusion on their own that Russia is a

³⁶ Tol, Gonul. “NATO Can Be a Force for Democracy in Turkey.” International New York Times, July 18, 2016.

venal partner and is not worth the risk of endangering its good ties with NATO. As a gesture of good will, the Alliance should seriously consider the candidacy of Turkish Secretary-General in the future. In the 64 years the position has existed, there has never been a Turkish candidate which would go a long way to changing perceptions inside Turkey about the level of equality among members. As a by-product, it subsequently would reinforce western values inside Turkey at a time when they are needed more than ever. While reform is not as simple as ordering another pot of tea, there is too much history and success among NATO and Turkey to speculate on the demise of transatlantic ties. While the frequency of being served a poor pot of tea is rare, the distaste of the current pot of transatlantic tea is long overdue for change!

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6. 2. Soft Power in Hard Times – The Moldovan Battlefield

SUBMITTED BY

Adriana Popa

ABSTRACT

In the context of a theorized shift in preference from “hard” to “soft” power in the case of modern actors on the global stage, this paper discusses of Russia’s (the East) and the European Union’s (the West) attempts to exercise “soft power” in Moldova, with the goal of maintaining/adding the small country in/to their sphere of geopolitical influence. The paper also comments on a third, “mediating” actor, Romania, and its potential to influence Moldova’s cultural and political identity. Last, the paper comments on the implications the “soft power” interplay and the Moldovan “battlefield” may have for regional security and for the future of the Eastern European microcosm.

1. THE CHANGING NATURE OF POWER

In 1990, Joseph Nye posited that although military force remained the ultimate form of power in a self-help system, the use of force was rapidly becoming more costly for modern powers, with other elements (communication, organizational and institutional skills, and manipulation of interdependence) gaining increasing importance.¹ The distinction between what Nye identified as “hard” and “soft” expressions of power turns on whether power is enacted through attraction or coercion,² with “soft power” resources, of particular importance to this essay, highlighted as cultural attraction, ideology, values/norms and institutional frameworks.³ By commenting that the ability to affect what other countries want tended to be associated with intangi-

¹ Nye, Joseph S., Jr., ““soft power””, *Foreign Policy*, # 80, 1990, p. 157

² Mattern, Janice, “Why `”soft power”” Isn’t So Soft: Representational Force and the Sociolinguistic Construction of Attraction in World Politics”, *Millennium Journal of International Studies*, # 33, 2005, p. 609

³ Nye, Joseph S., Jr., ““soft power””, *Foreign Policy*, # 80, 1990, p. 167

ble/“soft” power resources, Nye concluded the “soft” (co-optive) power was beginning to rival in importance the “hard” (coercive) power. However, in 2005, Janice Bially Mattern introduced an important clarification; while referring comparatively to “soft” and “hard” power (“soft power” being the ability to achieve desired outcomes through attraction rather than coercion);⁴ she commented that “soft power” should not be understood in juxtaposition with “hard power” but as a continuation of it by different means.

A particular country in Eastern Europe is proving an eloquent illustration of Nye’s prediction of increased importance of “soft power”, as well as of Mattern’s discussion on the capital “soft power” possesses in terms of its use to achieve the same goals for which “hard power” is no longer adequate or effective. This essay will focus on the “war for hearts and minds” currently taking place between the East (represented by Russia) and the West (the European Union) in the small, highly contested, post-Soviet country of Moldova, a regionally important, yet largely ignored, geopolitical battlefield, which is still generally free of “hard power” interventions (unlike other regional neighbors). As Nye and Mattern’s work has proven, distinctions between types of power and their respective influence are highly relevant in understanding their present interaction and the broader geopolitical and cultural environment. This paper will analyze the different types of “soft power” employed by the two actors with interests in Moldova, as well as comment on a third actor, which is seemingly mediating for the western side, but shares many cultural and historical elements with the eastern side as well – Romania, Moldova’s more developed neighbor. The paper will consider “soft power” a force actively exercised by both Russia and the EU/Romania, and focused on cultural/ideological/normative appeal (and the symbolic value of economic and legislative initiatives), rather than military and economic measures.

As this essay will argue, Moldova possesses considerable, if overlooked, strategic importance, especially given the recent context of renewed Russian aggression and apparent expansionism. In particular, the paper will comment on Romania’s “soft power” influence on regional security, which still lies ahead. By examining this potential and briefly discussing the Romanian-Moldovan history, as well as the manifestations of both

4 Mattern, Janice, “Why ‘soft power’ Isn’t So Soft: Representational Force and the Sociolinguistic Construction of Attraction in World Politics”, *Millennium Journal of International Studies*, # 33, 2005, p. 583

European and Russian “soft power” in Moldova, this essay will conclude with a view to the future in this troubled East-European microcosm.

2. A TALE OF THREE COUNTRIES

Under the larger framework of Eastern European security, the tiny Republic of Moldova, on the North-Eastern border of Romania, in Ukraine’s South-Centric area, deserves considerably more attention than it has received, especially at present. The poor former Soviet state has not only had an interesting quest for identity throughout its history (especially in the past twenty-five years), and continues to be divided, culturally and politically, between the East (Russia) and the West (Romania) but, more importantly, possesses considerable, if overlooked, strategic importance, especially for the oscillating, continually contested border between the Russian and western (Nato/EU) spheres of influence.

Moldova’s complicated relationship with its neighbors can be traced back hundreds of years, but a few episodes merit mentioning: in 1812, the Russian Empire gained the eastern half of the territory of the Principality of Moldova (along with Khotyn and Bessarabia, which the Russian Empire had already conquered and annexed), at a time when, although sharing linguistic, religious and cultural similarities, Moldova and “Romania” (distinct from what we know today as the state of Romania) were not integrated into one political and territorial unit. In 1918, this eastern part of Moldova (called “Bessarabia”) united with Romania, to form “Greater Romania”. In 1940, as a result of the secret Soviet-Nazi Ribbentrop-Molotov Pact, Bessarabia and Northern Bukovina passed from Romania to Russia, and the Moldavian Soviet Socialist Republic (MSSR) was founded shortly after.

Culturally, Moldova underwent periods of “Russification”, through forced settling of certain ethnic groups (mostly Russians, Belarusians, and Ukrainians) and expulsion/deportation of others (such as Romanians and Jews), and the gradual removal of the Romanian language from official and religious use. In Moldova, the Soviet government initiated multiple campaigns dedicated to promoting a “Moldovan ethnic identity” distinct from that of Romanians – for example, official Soviet policy asserted that the language spoken by Moldovans was different from the Romanian language.

Moldova remained under Soviet control until 1989,

when, along with several other Soviet republics, it started to move towards independence. In 1989, the Moldavian SSR adopted a language law that proclaimed Moldovan (written in the Latin script) to be the state language of the MSSR. Its identity with the Romanian language was also established. Opposition to the Communist Party grew, and, following the generalized unrest, the first democratic elections were held in February and March 1990. Moldova declared its independence on August 27th, 1991, and Romania was the first state to recognize it. In 1992, Moldova introduced a market economy and liberalized prices. In March 1992, the country gained formal recognition as an independent state at the United Nations, and in 1994, Moldova became a member of NATO's Partnership for Peace program, and in 1995, a member of the Council of Europe.

1990 marked an apparent Moldovan rapprochement with Russia, as an independent Pridnestrovian Moldavian Socialist Republic was proclaimed in Transnistria (the region east of the Dniester river, inhabited predominantly by Russian-speaking populations of Ukrainian and Russian descent), with its capital in Tiraspol. The move was motivated by fears of rising nationalism in Moldova and the country's expected reunification with Romania upon secession from the USSR. Further, in 1994, plans for a union with Romania were abandoned, while the new Constitution gave autonomy to the breakaway regions of Transnistria and Gagauzia. In 2001, the country became the first post-Soviet state in which a non-reformed communist party returned to power. The Party of Communists of the Republic of Moldova remained in power for eight years.

The troubled relationship between Moldova and its neighbors continued for the next few years, with the country oscillating between closeness to Russia (in 2001–2003 relations between Moldova and Russia improved) and to the West (2003–2010 marked important steps for Moldova towards closer integration with its neighbors and with the European Union and a distancing from Russia). Most recently, the country has seemed to pursue a pro-European path, even though it remains dependent on Russia economically (chiefly, on Russian gas and the Russian market for its products). 2005 saw the birth of an action plan (signed by Moldova and the EU) aimed at improving collaboration with its neighbors, Romania and Ukraine, as well as the establishment of EUBAM (the European Union Border Assistance Mission), and at aiding the Moldovan and Ukrainian governments to bring their border and customs procedures up

to EU standards. 2009 and 2010 saw generalized political and social unrest in Moldova, following which the Pro-European Coalition was formed on May 30th, 2013 (organically formed by representatives from three Moldovan political parties, and with a clear mission to bring Moldova into the EU, the Coalition stayed in power from May 2013 to February 2015).⁵ More importantly, in November 2013, Moldova signed an association agreement with the European Union (dedicated to the European Union's "Eastern Partnership" with ex-Soviet countries),⁶ followed by the signing of the full Association Agreement with the EU in June 2014. Romania publicly declared, in 2013 (through its President at the time, Traian Basescu), that it would support Moldova's joining the EU as a full member, while also declaring that the unification of Moldova with Romania would be the next national project for Romania.⁷

3. WITH DIFFERENT WEAPONS

Throughout its history, Moldova has struggled between two clashing identities and trajectories; between the East, represented by Russia, and the West, represented by Romania (closer), and the European Union (farther). While the western examples could be amalgamated, as Romania is now a member of the EU, I believe drawing a distinction between them is important when discussing the "soft power" potential of Romania on influencing Moldova's destiny. To most Moldovans, the EU is a distant relative, seemingly interested in their well-being, but pragmatic enough to consider its own gains from welcoming Moldova into the bosom of the family, and realistic enough to maintain significant barriers to integration until Moldova fulfills the necessary criteria for acceptance. Known as the Copenhagen Criteria, these are a set of rules that define a country's eligibility to join the European Union – the three main requirements are that the state has the institutions to preserve democratic governance and human rights, has a functioning market economy, and accepts the obligations and intent of the EU.⁸

5 "New Moldovan Pro-European Coalition Formed", May 2013, European Forum, http://www.europeanforum.net/news/1692/new_moldavan_pro_european_coalition_formed

6 EU-Moldova Association Agreement, European Union External Action, <http://eeas.europa.eu/moldova/>

7 "Basescu: Urmatorul proiect de țară al României, unirea cu Basarabia", România Liberă, November 2013, http://www.europeanforum.net/news/1692/new_moldavan_pro_european_coalition_formed

8 "Speeding Up Moldova's EU Integration", Romanian Center for European Politics, Policy Memo 54, July 2014, <http://www.crpe.ro/en/speeding-moldovas-eu-integration-process-progress-field-anti-corruption-lessons-learned-croatia/> and "Moldova and the EU – Not a Success Story Yet", The Economist, December 2012, (<http://www.economist.com/blogs/easternapproaches/2012/12/eu-and-moldova>)

Russia is a past Moldova has grown if not comfortable with, at least accustomed to, especially as it continues into the present, through a virtually permanent involvement in the small country's politics, economy, and culture. Geographic, cultural, and political proximity, not to mention Moldova's economic reliance on Russia (mainly through its reliance on Russian gas) make Russia's power over Moldova a certainty, compared to the distant influence of the European Union. Romania sits comfortably in the middle, alike enough to Moldova to be worthy of its trust and to be credible when it declares it understands its plight, but also high enough on the ladder of political and economic success that it can exert a powerful influence exemplifying the achievement Moldova desires for itself – a European destiny. It is this influence, which for the purpose of this essay shall consider the tools of “soft power”, which provides a vital resource for increased regional stability and perhaps the best option for security in the region.

3.1 IN THE RUSSIAN SHADOW

In July 2014, Iulian Fota, Romania's presidential national security adviser commented that “Putin's Russia will not fight conventionally for territory in the former satellite states, but unconventionally for hearts and minds. (...) He knows that the flaw of the Soviet Union was that it did not have “soft power”.”⁹ Russia's wielding of “soft power” in Moldova – a particular brand of it, based on popular appeal and political pressure – makes for an interesting study. Russia has been using its cultural, political, and economic capital, and a plethora of capacities to legitimate its presence in the small post-Soviet republic. Moldova is important to Russia not merely as a former Soviet state, but due to the significant pro-Russian tendencies in its society (in recent polls, as many as 45 percent of the population prefers membership of the Russia-led Customs Union rather than a European future. the fact that several Moldovan regions are overtly pro-Russian, such as the southern one inhabited by about 140,000 ethnic Gagauz),¹⁰ which Moscow feels confident it can manipulate to its advantage, and due to its proximity to Romania - a member of both NATO and the EU.

Its heavy dependence on gas supplies from Russia marks one of the core Moldovan economic weaknesses, which Moscow

⁹ Kaplan, Robert D., “Why Moldova Urgently Matters”, Stratfor, Global Affairs section, July 2014

¹⁰ Antidze, Margarita and Tanas, Alexander, “Defying Russian warnings, Moldova and Georgia head for EU pact”, Reuters, June 2014

has subtly acknowledged being an area of continued interest and potential action, according to Moldova's political decisions. Attending a Russia-Moldova joint economic meeting in late 2014, Dmitry Rogozin, the Russian deputy prime minister and Kremlin envoy to Transnistria, warned Moldova about the speed of its European integration; "Traveling at such a speed, a locomotive can lose its rear carriages".¹¹ Right before winter 2014, he made another controversial statement, telling Moldovans "I hope you don't freeze,"¹² a reference to their country's dependence on Russian natural gas, which is mainly used for heating and which Moscow has sometimes cut off during political disputes. In an addition to Russia's anti-EU rhetoric, Rogozin referred to the Moldova-EU agreement as an "anteroom" where Moldova "may be kept rather long and twisted around the EU's little finger".¹³ Additionally, with the Commonwealth of Independent States (CIS) currently Moldova's biggest market, many Moldovan industries are worried about the impact an EU deal would have on their revenue. Moscow is, of course, aware of this, and it has used its economic and political tools to deter further Moldovan advancement towards Europe.

Russia's "soft power", which was most recently put to use during Moldova's 2014 parliamentary election campaign, is a different brand from that of the European Union. Moscow provides continued and well-funded support to Moldova's Socialist Party, has repeatedly been proven to exert pressure and influence over the media, and routinely seeks to manipulate decisions made by Moldovan political leaders through blackmail, extortion, and threats. Russia is also the de facto dominant cultural and economic force in Moldova. Almost 35 percent of Moldova's products are exported to Russia, Russian language schools abound across the country, in Chisinau's central park the Russian poet Alexander Pushkin looks down from his pedestal, Russian music and media fill the airwaves, Russian gas warms Moldovan homes, and Russian companies employ at least 200,000 people – 17.5 percent of Moldova's population.¹⁴ It is no wonder many Moldovans feel significantly more attached to Russia than to Europe.

However, the draw to Russia undergoes periods of height-

11 Antidze, Margarita and Tanas, Alexander, "Defying Russian warnings, Moldova and Georgia head for EU pact", Reuters, June 2014

12 Birnbaum, Michael, "Russia pressures Moldova and Ukraine ahead of signing of E.U. Association Agreement", The Washington Post, June 2014

13 "Russia threatens Moldova over its EU relations", Euractiv, March 2013

14 Varshalomidze, Tamila, "Moldova stuck between Russia and the EU", Aljazeera, May 2014

ened intensity and detachment. When Moscow’s “soft power” campaign (based on discrediting the EU and infused with pro-Russian rhetoric reminiscent of the Soviet era) immediately before Moldova’s signing of the EU Association Agreement failed to deter the signing, Moscow hinted at economic measures, and threatened to cut off its energy supplies, as well as to impose several kinds of trade embargoes (which would be potentially crippling for a Moldova heavily dependent on Russia for its energy, trade, and labor market for migrant workers) and ban imports of wines, meat, and vegetables from Moldova. Socially and politically, Russia has used its significant influence in several Moldovan regions to spark or support separatist and anti-European movements, most notably in Transnistria (where for several years Russian-backed leaders have been trying to break away from Moldova – and where a massive granite statue of Lenin stands in front of the main government building, a hammer and sickle adorn the flag, and new aquamarine public buses donated by Russia ply the streets of Tiraspol, bearing brightly colored slogans that pledge, “Into the future, together with Russia”),¹⁵ and in Gagauzia (where the Kremlin openly supports calls for more autonomy, if not independence from Moldova, and where inhabitants oppose closer ties with Europe, but support a rapprochement to Russia).

Leaders in Chisinau have repeatedly reinforced their commitment to a European path for Moldova, even at the risk of economic pressures in the short term in the event of a Russian backlash.¹⁶ But while Moldovans may feel their cultural and historic ties to Russia, in addition to economic realities, might make an abrupt rupture from Moscow unwise, and despite Russia’s anti-EU and pro-Moscow PR campaigns, Moldovans are quick to point out that they will resist coercion from their neighbor. Deputy Foreign Minister Iulian Groza declared on national television in December 2014, “We don’t want to protect ourselves from Russia. We believe that our relationship with Russia should be developed with the respect of sovereignty. Our interest is one thing – to develop Moldova. But we don’t believe that by constraint you can force someone to marry you”.¹⁷

¹⁵ Birnbaum, Michael, “Russia pressures Moldova and Ukraine ahead of signing of E.U. Association Agreement”, *The Washington Post*, June 2014

¹⁶ Birnbaum, Michael, “Russia pressures Moldova and Ukraine ahead of signing of E.U. Association Agreement”, *The Washington Post*, June 2014

¹⁷ Birnbaum, Michael, “Russia pressures Moldova and Ukraine ahead of signing of E.U. Association Agreement”, *The Washington Post*, June 2014

3.2. ROMANIAN RAPPROCHEMENT

“Let us extend the great hora/Closer to the border/All the way to Basarabia”. Thus goes a well-known Romanian patriotic song. People on both sides of the Dniester regard it as a reminder of the bonds of brotherhood between Moldovans and Romanians. People in both countries point out that they used to be one common people, with a common land, language, and religion before the vicissitudes of history tore them apart. But Romania and Moldova continue to share an undeniable past, and may yet come to share a European future.

For Moldova, Romania is a close example of “yes we can” with respect to breaking away from its Soviet past, and joining the European family. It is a closely related country that experienced the same bleak specter of communism and emerged to claim its own future, first as a fully independent nation, and then as a full member of the EU. It is for all these reasons that Romania holds considerable “soft power” capital with regards to Moldova, especially when compared to a European Union that might seem distant, foreign, and at times disengaged/uninterested in Moldova’s destiny, and to a highly involved Russia, that is seeking to maintain Moldova in its sphere of influence.

However, it is less certain to which extent Romanian support is purely altruistic and uniquely motivated by a deep sense of shared identity. In the maneuvering of its appeal to Moldovan population (to which, naturally, the already pro-Romanian/pro-European part proves most receptive) and its continuous support for and collaboration with the Moldovan political leadership, Romania could not only seek to cement a historic tie, and achieve increased cultural rapprochement, but would also undoubtedly benefit. A fully European integrated Moldova would provide an open economy for which Romanian products would find a new market, a capable, strong partner in areas of collaboration such as customs control and data sharing, and, of course, increased mobility between the two countries (either through Moldovan integration into the EU or unification with Romania) which would infuse the Romanian labor force with fresh talent from a neighboring country. Besides the cultural, economic, and security advantages described above, Romania would also likely benefit from a strong partner in its juxtaposition (increasingly tense) with Russia, and would increase its legitimacy should it become the orchestrator or main supporter of a successful western integration of a new EU member (Romania has already

shown signs of seeking to amass political capital in international circles through its support for its Moldovan “protégé”). At the same time, worrisome prospects would be an increased Russian sense of insecurity and of being “cornered” or “betrayed” (of increased salience due to the fact that Moldova, unlike Romania, is a former Soviet state), which could lead to an increased defensive stance by Moscow, intensified pressure on Moldova’s internal environment, given its multi-ethnic background and territorial/political enclaves with strong desires for autonomy (such as Transnistria and Gagauzia), and accusations of “imperialist” or “annexationist” ambitions leveled at Romania (which routinely accompany any talk of reunification with Moldova, and reverberate through certain pockets of the Moldovan population).

Romania’s support for Moldova’s European path has benefited not only from EU support – the European Commission’s Neighborhood Program for Romania and Moldova pumped new life into the relations between the two countries¹⁸ – but also from Romania’s own brand of “soft power”, through several initiatives in the past few years, most of which have proven not only popular with most Moldovans, but instrumental in bringing Moldova closer to full European integration, and making it less dependent on Moscow.

In 2009, Romania launched an initiative effectively offering citizenship to any Moldovans who could prove recent Romanian ancestry. To date, more than a million Moldovans appear to have taken advantage of the offer.¹⁹ Romania followed up with a 2010 similar legislative initiative, bestowing hundreds of thousands of Romanian passports on Moldovans seeking to gain entry not only into Romania but into Western Europe, mostly as low-skilled, cheap labor. The numbers of Moldovans with access to Romanian passports has exploded, enfranchising tens of thousands of new voters – with each new election, more Moldovans with Romanian passports vote in Romanian elections.²⁰ In January 2010, the National Banks of the two countries signed an agreement covering several mutual projects and detailing the terms of cooperation for the next five years. Later that year, Moldova and Romania also signed a two-year action plan for detection of financial crimes and joint audits of customs transactions on the common border, as well as a training protocol for

18 Scott, J. W., “EU Enlargement, Region Building and Shifting Borders of Inclusion and Exclusion”, Ashgate, 2006, p. 144

19 Freeman, Collin, “Romania baits Russia by seeking reunification with Moldova”, *The Telegraph*, November 2013

20 Bird, Michael, “A union between Moldova and Romania: In the cards?”, *EUObserver*, March 2014

Moldovan specialists in auditing European funds.

In March, the office of Viorel Badea, deputy chairman of the foreign policy committee in the Romanian Senate, opened in Chisinau. In April, the presidents of the two countries signed a joint declaration on the establishment of a strategic bilateral partnership for Moldova's European integration, with Romania acting as the advocate for Moldova's entry to the EU and coordinating the transfer of information and expertise from the more "senior" Bucharest to the more "junior" Chisinau.²¹ In November 2010, the Romania Moldova bilateral "Treaty on the Regime of State Borders" ushered in a new period of mutual cooperation and assistance on border issues. Since the Alliance for European Integration (AEI) came to power in Moldova, the country's rapprochement with neighboring Romania has sped up,²² with Romania intensifying self and European promotion, expanding its presence in mass media and in the NGO sector, as well as in Moldovan state agencies. AEI was instrumental in getting Moldova to sign the Agreement on Small-Scale Border Traffic with Romania, and in the opening of two Romanian consulates (in Beltsy and Kagul). It was during this time that the barbed wire along the Prut River was removed, which was a highly symbolic move signaling the end of the separation between the two countries (with Moldovans living within a 30-kilometer radius of the border being able to enter Romania without a visa). July and September brought the signing of an interstate agreement on military cooperation, which envisaged joint military exercises, exchange of classified information, joint planning of defense operations and joint use of shooting grounds and other resources, as well as a new cooperation protocol between the two countries' intelligence agencies. Intensifying its "soft power" offensive in Moldova, Romania sponsored officials from Moldova's Foreign Ministry for courses on Euro-Atlantic integration and continues to pay for the translations of EU laws,²³ in addition to granting generous loans to its neighbor in the past year alone.

Reaction to Romania's exercise of "soft power", however, has differed in the two countries; with the Moldovan government counts nine of the fifty-three members of the current governing coalition with a second passport that is Romanian, and eleven others who have applied for one, and Chisinau Mayor

²¹ Tsirdya, Bogdan, "Romania and Moldova: the project of "latent integration"", Strategic Culture Foundation Online Journal, October 2010

²² Ibid

²³ Tsirdya, Bogdan, "Romania and Moldova: the project of "latent integration"", Strategic Culture Foundation Online Journal, October 2010

Dorin Chirtoaca declaring that “Romania and Moldova are closely linked, like Germany and Bavaria. The idea that the two states were independent of each other was an illusion of the Soviet powers”,²⁴ ordinary Moldovans remain divided in their trust in and interest for Romania, especially when the idea of “reunification” comes up. While several Romanian presidents have made public pro-unification statements (some even going as far as to suggest they consider Moldova part of Romania), and the majority of Romanians are in favor of unification, considerably lower numbers exhibit the same attitudes in Moldova. In fact, many have declared their intentions to only use Romania as their entry point into the European Union, without having a special affinity for the neighboring country itself. Despite Romania’s attempts to keep its unification rhetoric moderate, as it is frowned upon by the European Union, it remains a prominent, if controversial, “soft power” tool, centered on reminding Moldovans and Romanians of their common heritage. Romania has continually presented itself, both in rhetoric and in action, as a full and willing partner to Moldova for western rapprochement. Romanian President Traian Basescu addressed Moldova in April 2014, declaring, “If you ever have problems on your way to the European Union, just call Bucharest and say ‘we want to unite’ and it will happen ... no matter who will be the president of Romania, whether a right or left governing party, we will want unification.”²⁵ Promoted by pro-unionist movements on both sides of the border, including the “Friends of the Union” group of Romanian MPs, part of the umbrella organization Action 2012, with pro-unionist groups from Romania, Moldova, Switzerland, France, Italy, and the US, Moldova’s union with Romania is presented as an answer to its problems. Even despite the significantly lower numbers of Moldovans compared to Romanians who find this solution attractive, the rhetoric of “re-unification” comes in stark contrast to Russia’s talk of “re-annexation.”

Romania has backed its “soft power” campaign in Moldova with concrete support initiatives, through building economic, social, and cultural relations between the two countries, such as greater transport links, support for Moldova’s education system, study grants in Romania for Moldovan students, increased political dialogue, and cooperation between government agencies. Since 2010, as Russia has restricted imports of Moldovan wine, fruit, vegetables, and meat, Romania has overtaken

²⁴ Ibid

²⁵ Corlateanu Mila, “Much Ado About Moldova”, *New Eastern Europe*, April 2014

Russia as Moldova's largest trade partner,²⁶ and also released €100 million in aid to Moldova to support education and infrastructure. Moldovan students in Romania enjoy special privileges, and in 2014, 100 Romanian micro-buses, as well as hundreds of thousands of books were donated to schools in Moldova. In February 2015, Romania set up an emergency ambulance service in Balti, Moldova, with further plans for SMURD (Romania's emergency ambulance and rescue service) to straddle the border in the near future. As well as training Balti's medical workers, Romania donated five ambulances to the city and rescue helicopters, based in Romania, now fly across the border, taking victims to Chisinau, or, if they have dual Romanian-Moldovan citizenship, even to Iasi.²⁷

Perhaps the most significant step Romania has taken in recent years has been a move to counteract Moldovan energetic reliance on Russian gas – in 2014, a pipeline that would carry gas from Romania into Moldova (the bulk of the cost was born by Romania, and EU funds covered about a third)²⁸ was inaugurated. Projections connected to the pipeline forecast that in a few years, Moldova's energy system will be perfectly interconnected with Europe, giving it a solid alternative to buying gas from Russia.²⁹ A strategic move in the “soft power” game, the pipeline was symbolically unveiled on the twenty-third anniversary of Moldova's independence from the Soviet Union. It was also telling that the inauguration came against a backdrop of painfully recent lessons from Ukraine, that has had its Russian gas supply stopped three times in the last decade, at key moments of political tension.

Romania has also increased its assistance with Moldova's financial and legal reforms, including efforts to combat tax evasion and money laundering, as well as its international lobby on behalf of Moldova, especially with the EU. In April 2014, several Romanian Members of the European Parliament gave public declarations insisting that the European Association Agreement with Moldova be signed no later than July 2014, arguing that it would be possible for Moldova to rise to European expectations by then, and that the application of the agreement would have a positive influence on the quality of life of Moldovans, as well as increase their support for the EU – a more subtle reference to the “war for hearts and minds” between the East and the West

²⁶ “Romania sends ambulances to Moldova in tug-of-war with Russia”, Reuters, February 2015

²⁷ Ibid

²⁸ “Moldova opens Romania gas pipeline to ease Moldovan Dependence on Russia”, EUBusiness, August 2014

²⁹ “With Romanian Gas, Moldova Seeks Energy Independence From Russia”, Voice of America, August 2014

taking place in Moldova. Such declarations from Romanian politicians, in alignment with general Romanian discourse on the Moldovan issue, as well as the myriad of initiatives Romania has undertaken to support Moldova's European path, constitute a considerable "soft power" resource for the purpose of drawing Moldova closer to the West. As such, Romania wields considerable influence for regional geopolitical strategy and development.

That Romanian culture and ideology are attractive to at least part of the Moldovan population (excluded here are groups with pro-Russian sentiments and/or those who identify strictly with a Moldovan identity, as distinct from a Romania one) is not only an evident fact, but underlines perhaps Romania's greatest "soft power" resource towards Moldova – as Janice Mattern explains, a common lifeworld or culture allows actors to become embedded in it, to the point of sharing values and ideas with one other, and increasing their respective legitimacy in each other's eyes.³⁰ As both Nye and Mattern suggest in terms of policy prescriptions, Romania has not wasted any time "harvesting" its "soft power" by spreading social knowledge about its shared values, history, and culture with Moldova³¹ and "cultivating attraction" through public diplomacy (as Nye suggests, with an insistence of identity-related discourses – "who we are as Romanians, and what we share, Moldovans").³²

If "soft power" convinces others that they should follow because of the allure of an other's way of life,³³ then the attractiveness of Romania's political and cultural values, ideals, visions, standard of living, and newly-found European destiny surely qualifies as a potent resource of "soft power" influence towards Moldova. "If a state can make its power seem legitimate in the eyes of others, it will encounter less resistance to its wishes; if its culture and ideology are attractive, others will more willingly follow; if it can support institutions that make other states wish to channel or limit their activities in ways the other state prefers, it may be spared the costly exercise of coercive or hard power"³⁴ –wrote Nye in 1990, and the applicability of these elements in the Romania-Moldova relationship seems to indicate that Romanian influence will continue to mark Moldova's steps

30 Mattern, Janice, "Why 'soft power' Isn't So Soft: Representational Force and the Sociolinguistic Construction of Attraction in World Politics", *Millennium Journal of International Studies*, # 33, 2005, p. 595

31 *Ibid*

32 *Ibid*

33 *Ibid*

34 Nye, Joseph S., Jr., "soft power", *Foreign Policy*, # 80, 1990, p. 166

on a new path for autonomy and development.

3.3. EUROPEAN EUPHORIA

That both western and eastern camps exercise their “soft power” in the Moldovan battlefield is undeniable. That those brands of “soft power” are inherently different has been less discussed.³⁵ The EU’s “soft power” resides mostly in positive promises and rewards for the behavior and achievement it seeks to cultivate in its member or aspiring member states. As such, what drives Moldova (and similar aspiring EU members) towards the West are the prospects of political and economic assistance, including increased mobility (such as the visa-free travel that was recently granted to Moldovans), work and residency rights on the territory of the European Union, a free trade zone with European countries, the prospect of cheaper imports of consumer goods from Europe, and, naturally, a sense of legitimacy and protection. However, Moldovan leaders recognize the political significance and symbolism of joining the EU, besides pragmatic considerations; Thomas de Waal, an independent analyst from the Carnegie Endowment for International Peace, explained that despite marking the beginning of a process, not the end of one, “the symbolism of a signed agreement in Brussels is enormous – that is why both Georgia and Moldova are so eager to have it.”³⁶ Echoing this, Moldovan Prime Minister Iurie Leanca told Reuters in a 2014 interview that Moldova would keep pressing for deeper ties with the EU, and that “the signing of the agreement is not the final full stop in our European aspirations. The next step is even more important – receiving the status of a candidate member of the EU.”³⁷ It is a mark of Europe’s “soft power” that many Moldovans believe that integration will bring the adopting European social values, viewed by most as progressive and free-thinking.³⁸

Integration, however, is also plagued by many doubts – large groups of Moldovans believe the rampant corruption that still plagues the Moldovan political system makes the country unprepared for a European commitment, and places uncertainty over the genuine goals of the European Union, and its interest in

³⁵ Baleanu, V.G., “In the Shadow of Russia: Romania’s Relations with Moldova and Ukraine”, Advanced Research and Assessment Group (ARAG), August 2000

³⁶ Antidze, Margarita and Tanas, Alexander, “Defying Russian warnings, Moldova and Georgia head for EU pact”, Reuters, June 2014

³⁷ Ibid

³⁸ Varshalomidze, Tamila, “Moldova stuck between Russia and the EU”, Aljazeera, May 2014

Moldova. Romania, its now-European neighbor, usually hailed as an example of success, is sometimes regarded with suspicion. Several voices in Moldovan media, for example, believe the EU merely wishes to drown Moldova in debt to force a reunification with Romania and restore the geopolitical order of the pre-Soviet era region. But Romania is generally regarded with interest and admiration, a model to be emulated. One of Romania's greatest "soft power" capitals comes from the example of positive repercussions that joining the EU had on the country. From economic development, to political restructuring, to justice reforms that have made important dents in corruption, and finally, to changing social and civic attitudes (Romanian youth especially, now educated and working abroad in Europe, forced political reforms at several key moments)³⁹ make Romania a lesson to observe for Moldovans – what is more, a lesson that is right next door, from a country that has departed from a very similar background.⁴⁰

With regards to Russia, European and Moldovan leaders refer to positive engagement and collaboration. On its part, the European Union has moved towards maintaining a balance in the eastern European microcosm - in 2014 the Enlargement Commissioner, Stefan Füle, declared that "the Association Agreements with our partners will not be at the expense of their relations with Russia or any other neighbor."⁴¹ In May 2014, Octavian Calmic, Moldova's deputy economy minister, further reassured Moscow by explaining that Moldova would supply goods for both western and eastern markets, and maintain its close ties with the Commonwealth of Independent States⁴² (CIS) (the regional bloc of former Soviet Republics that Russia dominates and that Moldova is a part of). In other words, Moldova's increasing rapprochement to Europe need not worry Russia. Needless to say, it does.

4. A VIEW TO THE FUTURE

The Ukrainian crisis was at the forefront of foreign affairs debates for a considerable time. Despite concern over regional security in Eastern Europe being so ubiquitous, Moldova and its role in regional affairs have been largely ignored, with the

³⁹ Varshalomidze, Tamila, "Moldova stuck between Russia and the EU", Aljazeera, May 2014

⁴⁰ "Speeding Up Moldova's EU Integration", Romanian Center for European Politics, Policy Memo 54, July 2014, <<http://www.crpe.ro/en/speeding-moldovas-eu-integration-process-progress-field-anti-corruption-lessons-learned-croatia/>> and "Moldova and the EU – Not a Success Story Yet", The Economist, December 2012, (<http://www.economist.com/blogs/easternapproaches/2012/12/eu-and-moldova>)

⁴¹ "Russia threatens Moldova over its EU relations", Euractiv, March 2013

⁴² Varshalomidze, Tamila, "Moldova stuck between Russia and the EU", Aljazeera, May 2014

exception of a few notable articles. In December 2014, “The Moscow Times” published an article titled “Moldova Is the Next Battleground for Russia and the EU”,⁴³ which seemed to support the idea that, like Ukraine, Moldova has become a geostrategic competition between Brussels and Moscow. The author even declared that, not unlike in the case of Ukraine, Russia will use any means at its disposal not to let the country slip away from its influence. In July 2014, Robert Kaplan confessed in “Why Moldova Urgently Matters”⁴⁴ that a western diplomat had warned him about the staunchly pro-Russian Balti potentially becoming a Moldovan Donetsk. Further reason to worry is that the EU remains torn between the desire of many member states to normalize affairs with Russia sooner rather than later, and the need to send a firm signal of European solidarity to Russia,⁴⁵ especially in the context of Ukraine, and of the right of Eastern-European states to opt for a European future. In this ambiguous European political environment, the fate of the Republic of Moldova is more uncertain than ever, and its fragility engenders worry.

While Russia did not go to the lengths it had pursued in Ukraine when the country’s political leaders, backed by unrelenting popular support, decisively and defiantly placed the country on a pro-European trajectory, it certainly did not shy away from displaying its displeasure when Moldova made a similar political manifest statement in December 2014, when the winning political coalition (the Liberal Democratic Party, the Democratic Party, and the Liberal Party) embodied the European course the country seems to enthusiastically seek. But the pro-European preference is far from unequivocal – like Ukraine, Moldova remains a country torn between the promise of a European destiny, and renewed closeness to Russia. There are plenty of voices (amounting to almost half, according to some surveys) who support proximity to Russia, and it is no surprise, with the country acting as the driving cultural and economic force in Moldova. Russia has not yet attempted any hard power measures in Moldova (in Joseph Nye’s understanding of the coercive use of military and economic means to influence the behavior or interests of other political bodies)⁴⁶, unlike in the case of Ukraine, where military intervention sought to discourage further European rapprochement. However, its use of “soft power” (in Joseph Nye’s under-

43 Dempsey, Judy, “Moldova Is The Next Battleground for Russia and the EU”, The Moscow Times, December 2014

44 Kaplan, Robert D., “Why Moldova Urgently Matters”, Stratfor, Global Affairs section, July 2014

45 Varshalomidze, Tamila, “Moldova stuck between Russia and the EU”, Aljazeera, May 2014

46 Nye, Joseph S., Jr, ““soft power””, Foreign Policy, # 80, 1990

standing of a country's ability to persuade others to do what it wants without force or coercion, its ability to attract others by the legitimacy of its policies and the values that underlie them, and the appeal of its culture, history, discourse, and principles),⁴⁷ through support, propaganda, and subtle to overt influence, has only intensified in the wake of Moldovan acts of independence and/or pro-Europeanism.

The most serious warning regarding Moldova was launched in early 2015 by the Supreme Allied Commander Europe (SACEUR) of NATO Allied Command Operations, Philip Breedlove. In a Congress hearing, he stated that Russian troops in Transnistria have as their chief goal the prevention of the country's further reorientation towards the West. Breedlove noted as a rule for identifying Moscow's potential targets those states where Russian propaganda is concentrated, "What needs to be monitored are the places where a powerful media campaign is about to be launched".⁴⁸ If this is indeed a reliable signal for the launching of potential Russian operations, then Moldova merits increased attention, as pro-Russian (and Russian-backed) media have the monopoly in Transnistria, enjoy a marked presence in Chisinau, and have recently been focusing intensely on the autonomous region of Gagauzia, where upcoming elections are to determine the next governor.

Breedlove's warning is echoed by Chancellor Angela Merkel, who has on repeated occasions mentioned Moldova as a new potential target for Russian interference. Germany's position has been rather firm from the outbreak of the Ukrainian crisis, with Chancellor Merkel repeatedly and publicly expressing concern over Moscow's involvement in the Balkans, and in potential escalations similar to Ukraine in Moldova, Georgia, and Serbia. Officially supporting Moldova as a future European partner and warning Russia that increased interference or aggression risks disrupting the entire European peaceful order, Chancellor Merkel has been following an unofficial goal: melting one of the last three "frozen conflicts" on the fringes of Europe (legacy of the Cold War), the resolution of which is blocked by Russia⁴⁹ – the Nagorno-Karabakh dispute between Armenia and Azerbaijan, the status of Georgia's breakaway regions of Abkhazia and South Ossetia, and finally, separatism in the Moldovan province of Transnistria.

⁴⁷ Ibid

⁴⁸ Campeanu, Cristian, "Ochiul lui Putin fixează Moldova", *Romania Libera*, Martie 2015

⁴⁹ "Why Merkel Is Taking Such a Keen Interest in Moldova", <http://www.euractiv.com/europes-east/merkel-keen-interest-moldova-analysis-514469>, Euractiv, August 2008

The ethnic, cultural, and political divides within Moldova make it a susceptible target for its neighbors' involvement, with Russia and Romania (and the EU) seeking to exploit the torn identity in the small country for their own benefit. As this essay has argued, Moldova carries important potential for regional security and stability, and its complicated relations with its neighbors, in addition to its torn identity, make it a case worthy of scholastic and governmental interest. The relations between Romania and Moldova, in particular, may have an important impact on Moldova's future, and on regional development, with Romania constituting an invaluable resource and important western ally. If Nye was right, and the changing nature of international politics has made intangible or "soft forms" of power more important,⁵⁰ then the Moldovan battlefield and the interactions of regional actors over it will not only become more salient in the years to come, but will also potentially underscore a new age of regional security.

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⁵⁰ Nye, Joseph S., Jr., "Soft Power", *Foreign Policy*, # 80, 1990, p. 164

