Challenges for European Foreign Policy in 2012

What kind of geo-economic Europe?

FRIDE

A EUROPEAN THINK TANK FOR GLOBAL ACTION

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Ana Martiningui and Richard Youngs (Eds)

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Abbreviations

ASEAN	Association of Southeast Asian Nations
ASEM	Asia-Europe Meeting
BRICS	Brazil, Russia, India, China and South Africa
CAP	Common Agricultural Policy
CELAC	Community of Latin American and Caribbean States
CSDP	Common Security and Defence Policy
DFID	Department for International Development
EBRD	European Bank for Reconstruction and Development
ECOFIN	Economic and Financial Affairs Council
EEAS	European External Action Service
EFSF	European Financial Stability Facility
EIB	European Investment Bank
ENP	European Neighbourhood Policy
EPA	Economic Partnership Agreement
ESS	European Security Strategy
EU	European Union
FAO	Food and Agriculture Organisation
FDI	Foreign Direct Investment

FTA	Free Trade Agreement
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
IEA	International Energy Agency
IMF	International Monetary Fund
ITGI	Interconnection Turkey-Greece-Italy Pipeline
MAP	Mutual Assessment Process
MENA	Middle East and North Africa
NATO	North Atlantic Treaty Organisation
ODA	Official Development Assistance
OECD	Organisation for Economic Cooperation and Development
PCA	Partnership and Cooperation Agreement
PP	Spanish Popular Party
PSOE	Spanish Socialist Workers' Party
PTA	Preferential Trade Agreement
SMES	Small and Medium Enterprises
SPRING	Support for Partnership, Reform, and Inclusive Growth
TAP	Trans Adriatic Pipeline
UAE	United Arab Emirates
UK	United Kingdom
UN	United Nations
UNASUR	Union of South American Nations
UNSC	United Nations Security Council
US	United States
WB	World Bank
WTO	World Trade Organisation

Geo-economic futures

Richard Youngs

At the end of each year, the FRIDE team reflects on the challenges likely to dominate the European Union's (EU) foreign policy agenda in the following twelve months. The unifying thread of these challenges for 2012 is that of geo-economics. Geo-economic thinking has been identified as an increasingly important shaper of EU external policy. The imperatives that derive from the euro crisis and shifts in global power require a more assertive focus on immediate economic interests. Analysts have heralded a 'return of geo-economics'. A concept that found itself out of favour in the more optimistic and less ribald 1990s has been dusted off. Geo-economics is likely to be of increasing relevance to European foreign policy debates in 2012.

In this volume, we aim to make a modest contribution to these incipient debates over geo-economics. Our team of researchers does this by examining more closely the geo-economic dimensions of European policies in a number of regions and by uncovering key member states' new economically-oriented international initiatives. We examine here the role of geo-economic thinking in the external policies of Germany, France, Spain and the United Kingdom (UK). And we pay particular attention to trends emerging for 2012 in Asia, the Middle East, Latin America, Africa and the Caspian basin; in each region our team identifies some of the crucial geo-economic choices and risks awaiting the EU in the next twelve months. In separate chapters, we also try to untangle the impact that geo-economic influences are likely to have on EU approaches to both global governance and security dilemmas. In his contribution, Pedro Solbes, former Spanish finance minister and monetary affairs commissioner, predicts that the external dimensions of the euro crisis are set to elicit far greater attention in 2012.

Geo-economics denotes the use of statecraft for economic ends; a focus on relative economic gain and power; a concern with gaining control of resources; the enmeshing of state and business sectors; and the primacy of economic over other forms of security. There is consensus that the ongoing economic crisis renders more pre-eminent the geo-economic dimension to international power and presence. Refining its geo-economic focus is widely seen as pre-requisite to the EU recovering ground lost as a result of the crisis. Geo-economics is also widely seen as a more central underpinning of the emerging 'non-Western' world order.

The question that arises is: precisely what form of geo-economics will EU member states pursue? It appears clear that geo-economics must be factored in as a significant influence over crisis-afflicted EU strategy. But geo-economics can assume different degrees and shapes. Geo-economic power can mean different things to different actors. What will be its defining contours in European policies as 2012 unfolds? What exactly does geo-economic prevalence mean for EU polices in particular regions and issue areas? What type of geo-economic power is the EU becoming and what type should it aspire to be? How are these considerations reflected in the main decisions likely to face the EU in 2012?

Our analysts concur that European member states have become strikingly more active in chasing investment deals. This trend is likely to become even more marked in 2012. Several governments

have explicitly committed themselves to a more assiduous pursuit of exports, investment contracts and very direct national material interests. In several regions, European external funding and development cooperation appears to be aligning itself more with the private sector. In at least some places, the danger is emerging of the EU becoming a mere supplicant for commercial contracts. This may produce important and immediate material gains, but also breeds a perception that the EU's external vision is increasingly and unduly constricted.

As a result of the crisis and intense competition from rising powers, in 2012 the focus on geo-economics will tip the scales even more towards bilateralism and away from common EU approaches. The chapters in this book reveal that competition is increasing between member states for commercial access to emerging markets, and that this has not been accompanied by coordination measures of equal weight at the EU level. The chapters also show how, despite enhanced commercial diplomacy, in most markets European companies are struggling to hold-off stiff competition across all sectors from non-Western producers. In 2012, the EU will face decisions over whether its plethora of initiatives – from outstanding free trade talks in Asia and Latin America, to energy projects in the Caspian and recently formulated strategic policy frameworks in the southern Mediterranean and sub-Saharan Africa – can move forward in more tangible and substantive terms.

However, it would be premature to conclude that geo-economics are entirely suffocating other dimensions of EU policy. Several of our chapters demonstrate how political and security policies in some circumstances still prevail. Relative to internal EU flows, European global trade and investment remains modest. If there has been something of a geo-economic stampede to Asia, the economic aspects of EU policies have if anything weakened in Latin America. In the Middle East and sub-Saharan Africa, trade and investment efforts have intensified but still underplay these regions' full potential.

Our analysts highlight that in general terms the investment in security-related resources will follow a downward trajectory in 2012 and the EU's foreign policy centre of gravity will tilt towards geo-economics. Nonetheless, in most areas the concern will not be with economics completely emasculating politics, but with insufficient priority being attached to conjoining these two strands of policy. The need is for a changed approach to diplomatic and security issues as a means of underpinning geo-economic interests. This is most clearly seen in the ferociously competitive energy politics of the Caspian region. Arguably, geo-economics should play to the traditional EU strength of being an 'economic giant, but political dwarf'; but in many regions it also reveals its Achilles Heel of an abiding disconnect between economic and geo-political interests. It is noted that foreign ministers have been largely absent in the management of the economic crisis.

Geo-economics does not mean the EU has abandoned rules-based multilateralism. In very broad-brush terms, the EU is suspended somewhere in between enthusiastic reliance on liberal interdependence and zero-sum survival mode. While EU member states are more aggressively pursuing investment and bilateral trade deals, they are not approaching geo-economics in the same kind of direct way that China and, to a lesser extent, the United States (US) plan for control over strategic resources and transport nodes of the global system. Yet, with most multilateral bodies struggling to retain traction, the EU will need to boost its commitment to multilateralism at key summits and key decision-moments scheduled for 2012, if it is to hold geo-economics back from more deleteriously eating into rules-based governance.

In sum, our chapters show that the risk to be avoided is that the current nature of European governments' focus on immediate commercial gain ends up being neither one thing nor the other: neither a coordinated and unified effort to use political tools to increase long-term control over economic assets, nor a coherent and whole-hearted orientation to multilateral rules. European approaches to geo-economics seem to take some of the priority away from issues of political governance and multilateral cooperation, but without encouraging member states to marshal all their resources to the purist form of *realpolitik* control.

The more positive interpretation to be drawn from the ten essays that follow is that this emerging approach could eventually constitute a well-balanced form of geo-economics: a firmer and more results-driven search for commercial gain, without the excesses of rules-weakening statecraft. But this mix will need to be pursued in a far less ad hoc and expedient fashion in 2012. A long-term exit from the crisis can best be driven by external EU policies that are motivated by material interest but within a framework that dovetails far more tightly with the broader gamut of geo-strategic objectives. Key choices in 2012 will have a bearing on how benign a form of geo-economics takes shape.

1. The euro crisis and EU geo-economics

Pedro Solbes

The EU agenda in 2012 will be dominated by the ongoing euro crisis. On most scores, things are likely to get worse before they get better. Crucial to this volume, there are several aspects of the euro crisis that have only just begun to be looked at seriously. These include the political and external aspects of Europe's economic turmoil. Concerns over the legitimacy of economic decision-making will have an impact on the general state of EU integration. And the read-over from the crisis to external policies will become a more preoccupying concern in the next twelve months. In 2012 the EU will be faced with a possible trade-off. The kind of two-speed flexibility useful for stabilising the euro crisis internally may undercut the foundations of a unified external geo-economic policy.

Deeper unity, sharper divergence

The economic crisis has highlighted the weaknesses of both the European economy and the euro itself. The limitations of the European economy, the euro's precariousness in facing the crisis and the delay in reacting to the problems of sovereign debt and the banking system have taken the EU vertiginously to the precipice. An eminently manageable crisis has morphed into an existential challenge for the euro and Europe itself. Economic recovery now seems a long way off. Slow global growth and the sovereign debt crisis in the Eurozone, particularly in the second half of 2011, have sown doubts about the euro and the entire European project.

Some insist that a more united Europe is the only path to exit the crisis. The traditional German idea of a more federal model has not been shared by other countries, particularly France. The December 2011 summit failed, of course, to reach agreement 'at 27' and in consequence has titled the institutional balance more towards inter-governmentalism. This could store up problems further down the line, not only in relation to the euro. It is not clear how much progress can be made without the federalism over which so many member states express unease. The UK may not prove the only problem here as unease is likely to appear in a number of national parliaments over the political implications of the moves to fiscal union.

In any case, advances in this direction will further increase differences between Eurozone countries and the rest. The concern about increasing divisions with the Eurozone will now dominate debate in the UK, in some Scandinavian countries and in new EU member states. The urgency to respond has frequently required euro members to resort to critical decisions without involving non-Eurozone countries. It is not just the procedure that is problematic, but also the possibly destabilising political foundations supporting such a form of ad hoc policy implementation. It is clear that Eurozone countries will do what they can to maintain the euro – even if this risks essential EU unity during 2012.

As the crisis has highlighted the risks of a single currency, the desire to join the euro is diminishing amongst new member states. Compliance with the convergence criteria is no longer the only step requisite to benefitting from monetary union. The new member states will have carefully to assess the sustainability of joining and evaluate other risks – the imbalances that can be created in a fixed economy as a consequence of giving up the exchange rate.

The new inter-governmental consultations agreed at the December summit will need to cooperate with Ecofin, the Eurogroup and the Commission. With more inter-governmental cooperation there will be more potential for division between Eurozone countries and the rest of the EU.

The consequences for democratic accountability will need to be addressed in 2012. Before prime minister Papandreou's announcement of a referendum on the Greek bailout package, the possibility of exit or excluding a country from the euro had already entered discussions. So had the question of whether it would be possible to create an alternative currency leading to a stronger euro. This debate triggered fears that a vote against the rescue package could result in Greece leaving the euro. Concerns regarding the potential risks of departure forced the idea to be withdrawn, but an important question remained: can these sorts of agreements be voted on by the public? In practical terms this should be contemplated before an agreement has been reached. But what does the future hold? It makes sense to hold referenda on future EU members, but legally it would be very controversial to do so with the euro, except in legal opt-out cases. In any event, leaving the euro would cause enormous problems for the affected country.

It is hard not to see further tensions on the horizon in 2012 over these essential questions of democratic accountability. There will be many circles to square. Polls show a huge majority of Greeks wishing to stay in the euro, but also opposing the reforms necessary to do so. Fund managers expressed doubts that the euro will hold together in its current form; yet governments insist there is no other viable option.

Of course, the Greek crisis, which started at the beginning of 2010, has still not been entirely resolved. Arguably, the initial decision not to resort to International Monetary Fund (IMF) assistance to address the problems of individual countries seems to have been a mistake. It resulted in the design and hasty implementation of a European crisis mechanism that was not considered or desired when the Maastricht Treaty was signed. Some have compared the EU's position in the Eurozone with the role that the IMF played in the Latin American crisis. In 2012 it may suffer the same kind of de-legitimisation associated with the IMF too. The economics and politics of the euro crisis will become increasingly enmeshed. Economic commentators have so far largely underplayed or missed this encroaching political dimension of the crisis.

The external read-over

To mitigate the crisis, more active external policies are paramount. The very depth of the crisis renders it more urgent to change the current system of global economic decision-making. The G7 has been replaced by the G20, which is becoming an organ for immediate action to contain the global deficit crisis. Given its initial success, the G20 could become the ultimate political authority that implements reforms that will lead to stable global growth. However, so far its success has been limited and, as evidenced by the recent Cannes summit, it has had to return to crisis management mode. Europe's inability to solve its own problems has diverted the G20 from other pressing issues. In 2012, the EU must move from being a drain on the G20 to being a problem-solver within the forum.

It is important to appreciate how deeply entwined are the G20's shortcomings with the EU's internal pathologies. The dominant role of Franco-German leadership has been evident since the German-French summit in Deauville in 2010 and was evidenced again by the preparations for Cannes. This mode of response may be essential to act quickly and efficiently in resolving the Eurozone's problems. But it does not help to create a more inclusive vision of Europe. This has been demonstrated by the crises in smaller countries such as Finland and Slovenia, and in the domestic opposition from a significant group of Tories against prime minister David Cameron on Europe. The December 2011 summit confirmed the worst fears of a split in EU unity, with divisions possible in a wider range of areas during 2012. These divisions increasingly feed into international bodies. Against this background, a key challenge for 2012 will be to prevent internal cracks debilitating the whole gamut of EU external action too.

The strengthened global position of developing countries has led not only to improved growth over recent years, but also left them less vulnerable to the effects of the crisis. Despite the expected drag effect, global growth will continue to come from these countries in 2012 and beyond. The role of rising powers in governing the global economy has accelerated and expanded since the crisis. Emerging economies now have to play an active role in global issues. Bilaterally, this can be seen in the pleas for China to fund the European Financial Stability Facility (EFSF) to re-finance the European sovereign debt. Multilaterally, it is witnessed through the request for additional support from the IMF.

From an EU perspective it seems as if changes to mitigate the crisis are moving fast, especially when compared to normal operating procedures and the complexity of the decision-making process. However, to other countries, international organisations and the market, these changes have been exasperatingly slow, opaque and insufficient. The changes decided at the December 2011 summit could signal the beginning of a new era, but procedural inefficiencies will surely remain. The EU's external geo-economics departs from weak foundations while this is the case.

In terms of trade, a return to protectionism has been avoided, despite strong political tension generated by high unemployment rates. But there has not been a move towards more liberalisation in the context of the Doha round. Although some developing countries have used their assistance to resolve ongoing trade problems (China basing its support to the EFSF on obtaining certain commercial conditions), the EU has nonetheless played an important role in this period in accepting Russia in the World Trade Organisation (WTO).

As a result of the crisis, the relative clout of the European banking sector has been reduced on a global level, even if the presence of the European financial system beyond the EU sphere is still very significant. The margin of financial manoeuvring to act beyond the EU has diminished; the priority is financing the internal market. The evolution of European banks' international strategies will be a key variable to track in 2012, and an issue so far insufficiently grasped by policy debates.

While European investment has been sizeable in emerging markets, the difficulties faced by many European firms in expanding their international reach has left much potential unrealised. Given the low growth predicted for Europe in 2012, stronger international presence will be fundamental to shoring-up the profitability of European firms. Plentiful words on this subject must be translated into action in 2012. As other chapters in this volume demonstrate, member states are undertaking a frenzy of new investment initiatives bilaterally; these need to be weaved into more common endeavours at the EU level.

There is no point thinking that 'decoupling' from the US economy is possible. Moreover, growth potential in a large part of the Eurozone will continue to be low if the international dimensions of the so-called EU2020 strategy – which commits the Union to become more globally competitive – does not have more of an impact than its predecessor Lisbon strategy. Most recent figures indicate that the highest growth levels will be amongst the new member states. Any fragile green shoots of recovery from the crisis have largely appeared through exporting to emerging and new markets. However, different approaches have been pursued by different countries according to the particular sectoral and geographical composition of their trade relations. Maximising international geo-economic reach and global competitiveness requires far more unified forward-thinking. The EU's approach to geo-economics should in this sense seek to limit the internal divergences emerging in the internal management of the euro crisis. These conflicting aims will require difficult balancing and trade-offs during the course of 2012.

Another salient point is how the international role of the euro evolves during 2012. Despite the crisis, the euro continues to play a fundamental role in the financial system. The euro exchange rate has not suffered as much as many predicted – so far. It is true that the European Central Bank's (ECB) recent decision not to act as lender of last resort has had a negative impact on the market, in part offset by the decision not to impose additional demands on the private sector in relation to sovereign debt. The use of third-party resources to refinance some of the sovereign debt will continue to be considered during 2012. Some focus on external exchange rate questions will need to take shape in 2012. There will need to be a boost to exports, but also a consideration of the long-term goal of widening the euro's international holdings.

All this will feed into other areas of foreign policies too. Although the EU has been a key actor in supporting security and development policies, we should not expect an improvement in these fields, given the financial restrictions that will certainly have to be considered in the EU budget following the forecasts for low growth. Funds will be scarcer to back up commercial deals in traditional fashion. This only strengthens the need for a more common and broad EU approach to geo-economics in 2012.

2. Geo-economics and global governance

Giovanni Grevi

The centrality of geo-economics will intensify in 2012. This trend will pose difficult choices for the EU's commitment to multilateral regimes. The return of geo-economics challenges international cooperation but does not entirely exclude it. Indeed, it requires global governance arrangements to adjust to new agendas and the emergence of new actors. Twenty-first century geo-economics carries different implications and entails different calculations. Setting the conceptual grounding for this volume, this chapter outlines the kind of geo-economic and global governance challenges that the EU will confront in 2012.

Geo-economics in an interpolar world

Twenty years ago, geo-economics was defined as the 'admixture of the logic of conflict and the methods of commerce'. This exposes the increasing importance of economic over military means to pursue political ends on the international stage. It stems from a realist perspective whereby competition for relative power remains the predominant driver of state behaviour, albeit through economic as opposed to military means.

A broader definition of geo-economics is required to capture the complexity of an interpolar world, where power and interdependence are inextricably linked. Geo-economics encompasses both the conversion of economic assets into political influence and the mobilisation of political power to achieve economic goals through a mix of competition and cooperation.

Economic performance is a top priority across advanced, emerging and developing countries. It is more consequential than sheer military might in the pursuit of national interests. The difference lies in the assumption that these interests are directed to maximise relative gains, as opposed to pursuing a broader range of goals to achieve sustainable gains over the long term.

The prosperity of major powers is unlikely to be achieved by their undermining each other. The current global economic crisis seems to prove this, since the default of a large economy would hit the others hard. Surplus and deficit economies are bound to each other, although global imbalances are unsustainable and need addressing. The renewed centrality of economics to political power therefore not only triggers competition but opens new scope for cooperation as well. Most powers are quite aware that they stand to lose from the breakdown of the international order more than they would gain from outdoing each other.

That said, the growing demand for cooperation will not necessarily result in the greater supply of effective collective action. The drift towards a zero-sum world economy and political conflict may not be the result of the deliberate choice of individual actors but the unintended consequence of the collective failure to manage interdependence.

A new geo-economic landscape

Geo-economics is back and will be at the forefront of EU external relations in 2012. This is because of the momentous redistribution of economic and political power in the international system, the consequent shift of trade and investment patterns, and the ensuing competition for resources to sustain growth. Sustainability was nowhere as central to geo-economics in the past as it is today, now that the so-called age of convergence (of living standards and consumption habits) meets the age of scarcity (of energy, food and water, among other commodities).

Fundamental trends are at work, which are transforming the global geo-economic landscape. The financial and economic crisis has amplified these trends, with long-term implications for global politics and governance frameworks.

While China, India and Brazil alone contributed 70 per cent of global growth in 2008 and 2009, the United States and the European Union may be facing a 'lost decade'. Growth will take place largely outside Europe in the next twenty years. China and India are expected to account for over 40 per cent and feature, respectively, first and fourth in the ranking of the largest economies by 2030 (with the US second and the EU third).

With global energy demand expected to jump by about 40 per cent up to 2030, the two Asian giants may account for over half of this increase. More strikingly, non-OECD – Organisation for Economic Cooperation and Development – countries' share of energy demand and CO2 emissions growth over the next twenty years stands in the range of 90 per cent. The International Energy Agency (IEA) reports that China's emissions alone will be equivalent to those of the US, the EU and Japan combined by 2035.

Trade and economic growth fuel each other. Developing countries' share of global trade has doubled in the past two decades to reach 45 per cent, and estimates suggest it will be 70 per cent by 2050. The volume of South-South trade has expanded tenfold between 1990 and 2010, from 9 to 20 per cent of total trade, and may reach 40 per cent by 2030. BRICS-Africa trade has grown eightfold between 2000 and 2008 and the BRICS' share of Africa's trade has risen from 4 to 20 per cent in the last twenty years. Trade between China and Latin America has grown 16 times between 1990 and 2009. The share of Brazil's trade with the other BRICS jumped from 9 to 17 per cent in only three years, from 2006 to 2009.

The geo-economic map of the world is substantially changing in three major ways. First, a wider range of important state and non-state actors matter to global politics and economics, diluting the political and normative primacy of advanced countries. Second, interdependence entails potential for mutual gains but also exposes mutual and asymmetric vulnerabilities. State and non-state actors are exposed to each other's decisions. Third, the resilience of the globalised world is challenged by crises that spread fast and elude policy divides, as the impact of economic growth on food security, or of environmental disasters on global supply chains, demonstrates.

The question for global governance is whether an international order predicated on a different balance of power and ideas will adjust to new actors and agendas, updating but not distorting its normative cornerstones, or be undermined.

The global governance stress tests

The new geo-economic landscape challenges existing international regimes, whose adaptation has been slow. In particular, global governance arrangements are subject to a double stress test. For one, the political stress: the discrepancy between the constellation of power and preferences, and the distribution of seats and votes in multilateral bodies. For another, the functional stress: the apparent mismatch between the interconnection of different issues (trade and development, climate change and security) and the fragmentation of institutional competences. This double stress test poses a direct challenge to the EU, whose principled commitment to support effective multilateralism is not always matched by common positions on governance reform or on priority agenda items.

In 2012, cracks in the global financial regime will widen under the burden of the crisis. The World Bank (WB) and the International Monetary Fund (IMF) have adopted reforms to redistribute quotas, votes and seats in respective organs. Under the 2010 agreement, two European countries will have to give up their seats on the (all-elected) IMF Executive Board in 2012. This is to match economic power shifts with a shift of institutional weight from developed to emerging countries. However, the process is slow and only indirectly tackles deeper problems and differences concerning global economic imbalances and financial regulations. The latter remain largely fragmented through different national regimes. This compounds financial volatility and the risk of further banking crises, despite some progress with the establishment of the Financial Stability Board and the adoption of the Basel III principles.

As to global imbalances, unilateral currency pegs to the US dollar by China and others have produced an unsustainable gap between deficit and surplus countries, which no multilateral institution has been able to check. The accumulation of foreign currency reserves by China and other emerging countries running a current account surplus amounts to a unilateral insurance policy. It signals little trust in the ability of the IMF or other multilateral bodies to provide emergency finance when need be. It also reflects political unease with the conditions that accompany IMF loans, which have traditionally reflected the normative preferences of predominant powers. However, recent debates on the contribution of large reserve holders like China and Brazil to support the Eurozone bailout package might pave the way to a further increase of emerging countries' influence in the IMF sooner rather than later.

Given the impact of the crisis on the US federal deficit and debt, the American addiction to foreign credit is denting the confidence in the sustainability of the US dollar as the principal reserve currency. The BRICS have called for a transition towards a multi-currency regime or a supranational reserve currency. While neither proposition is going to be implemented soon, the issue is likely to be present on the international agenda in 2012. In the meantime, the IMF remains relatively under-resourced to face new financial instability. Its enhanced surveillance of national economic policies under the G20 Mutual Assessment Process (MAP) marks a step forward but lacks political clout.

The multilateral trade regime will need to adjust more to the new geo-economic landscape in 2012. Emerging countries like India and Brazil have joined the top tables where key players strike big deals (or not) at the WTO. They are active in forums such as the so-called 'New Quad' and the G6. With advanced and developing countries engaging in antagonistic coalition politics, the growing heterogeneity of views and priorities has dragged consensus-based decision-making into a gridlock. Prospects for the conclusion of the Doha development round remain dim for 2012. Stalemate at the multilateral level is in contrast with the proliferation of bilateral and regional preferential trade agreements (PTAs), whose number reached 300 in 2010. Faced with the seemingly irreversible gridlock of the Doha round, the EU itself has pushed forward with bilateral and inter-regional trade agreements. In 2012, those with Canada and India are expected to be concluded, and negotiations on a free trade agreement with Japan launched.

Evidence points to a connection between the spread of PTAs and the cross-border fragmentation of production chains. Recent PTAs are typically 'deep' agreements including a focus on non-tariff barriers and regulation of non-WTO domains such as competition policy, investment regimes and the environment. These agreements are good for trade and off-shoring between the parties but risk generating confusion and regulatory frictions, and inconsistencies at the international level. They make arbitration between different rules more arduous. Given little political investment by heavyweights such as the US and China in the Doha round, there is a concern that bilateral and pluri-lateral agreements will become an alternative to, and not a complement of, further multilateral trade liberalisation pursued by the WTO. This would be detrimental to global trade, at a time when protectionist temptations are on the rise. While pursuing PTAs, the EU also advocates a new, pragmatic approach to multilateral negotiations. The focus in 2012 should lie on achievable gains where a critical mass of developed and developing countries can be brought together to strike separate deals.

Delinking economic growth from intensive resource consumption is perhaps the number one challenge that geo-economic trends pose for global governance. Crucial summits lie ahead in 2012 at which the EU will need to contribute to progress on this issue. Normative differences are strongest when it comes to balancing prospects for economic development with requirements to preserve natural resources and the environment at large. The common challenge of sustainability elicits different responses from advanced, emerging and less developed countries, and from within these groups. The political and the functional stress tests on global governance frameworks are the most acute here, not least because of the conjunction of energy and environmental policies. The international energy regime is a patchwork of overlapping agencies and forums. None has the adequate mix of mandate, membership (including producers and consumers) and authority to take a comprehensive approach at energy governance. In particular, concerns over energy security, stirred by and reinforcing geo-political tensions, have prevailed in the last few years over sustainability considerations. The EU will need to reverse this trend in 2012.

The global environmental regime, with the United Nations Framework Convention on Climate Change at its core, is also fragmented and affected by a lack of both resources and political consensus on how to share the burden of emissions' reduction. Piecemeal progress towards unilateral commitments for reducing emissions, achieved at the Cancun and Durban conferences, signals awareness that the challenge is very serious and that responsibility to address it is shared. However, the international mechanisms to oversee the so-called 'national appropriate mitigation actions' are loose. Advanced countries such as the US, Canada and Japan reject the idea of new binding targets to reduce emissions in the absence of some degree of equivalent commitments by big polluters such as China. In times of economic crisis, the EU itself is a less fervent believer in more ambitious targets if some large emerging and middle-income countries do not raise their game. The Durban summit was an important step forward. A consensus was achieved to negotiate a common framework with legal force by 2015, under which major carbon emitters would commit to emission reduction targets. At the same time, controversy on the shape and funding of the Green Climate Fund to channel resources to poor countries to deal with climate change will need addressing in 2012. In such a difficult political environment, the Rio+20 summit in June 2012 offers a major opportunity to re-launch a common agenda for green, sustainable growth.

Innovation and contamination

Global governance is in dire straits. But creative solutions are being worked out to sustain international cooperation in a new geo-economic context. In 2012 it will be critically important for the EU to remain at the 'technological frontier' of governance innovation, if it is to fulfil its overarching goal of strengthening effective multilateralism. However, the ways and means of promoting international cooperation may not be limited to those inherited from the past, chiefly consisting of the consensual adoption of binding treaties of universal application. Progress will require hybrid and sub-optimal arrangements involving different levels and modes of cooperation. That will put a special premium on the ability of the EU and its member states to work in full coordination in formal and informal formats, while exploiting their comparative advantages and networks.

Foremost among recent governance innovations, mirroring geo-economic trends is the elevation of the G20 to leaders' level and to the status of premier forum for international economic cooperation. The G20 can be seen as a direct output of the political and functional stress tests, or governance gaps, given the scope of its membership and of its agenda. This forum has launched significant new forms of networked cooperation among its members, involving international institutions and non-state actors, whose relevance to collective action is set to grow exponentially. In so doing, however, the G20 experience has exposed some of the serious deficiencies of global governance, notably concerning the peer-review of national policies and the monitoring of the implementation of respective commitments. These shortcomings affect governance arrangements well beyond financial matters, including for example measures to address climate change.

At a political and normative level, the G20 has performed as an important platform to enable the incremental contamination of different perspectives, as opposed to their sheer competition or clash. Progress in this direction is going to be slow and contested but also essential, given the centrality of burden sharing and fairness issues to new deals on the economy and the environment. Besides, all major powers are arguably more socialised today in the multilateral system than at any time in the past. Public frictions can also be interpreted as evidence of the sustained effort to engage and narrow differences on very complex issues. But it is equally important that the search for common ground does not fall prey to the imperative of universal consensus or to coalitional politics, which harden respective positions, such as in multilateral trade negotiations. The G20 emerged from its November 2011 summit in Cannes with an unclear identity; in 2012 its European members must work hard to delineate the forum's longer term role.

The EU has extensive experience in reconciling different positions among its members. It also has a significant appreciation for cultural and political diversity within and beyond the Union, and has invested credibility and resources into multilateral policy-making. The current debt crisis is threatening not only its growth prospects but also the very sinews of European political integration. The effectiveness and legitimacy of the EU as a strong promoter of international cooperation will be a function of its internal political cohesion. As momentous geo-economic trends reshape the world, the clock to reform global governance frameworks is ticking. The EU must waste no further time on this challenge in 2012.

3. What legacy for security and defence?

Jos Boonstra

The European Union makes very limited use of its defence capacities to pursue and safeguard its geo-economic objectives. Combining economic power with hard security remains a prerogative of individual member states. The economic crisis has put on hold further development of the Common Security and Defence Policy (CSDP), both in the hard and soft security spheres. Without US support and a meaningful participation in NATO, the EU simply does not have the hard security clout to back up its economic power and will be increasingly unable to respond to security crises.

2012 is likely to be a quiet year in terms of CSDP capacity-building. The Polish, Danish and Cypriot trio presidency's work programme is extremely thin on security and defence. Most attention will be devoted to fostering unity in NATO among allies, partners and old adversaries when heads of state meet in Chicago in May 2012. There are no ground-breaking CSDP revisions foreseen for 2012. Europe will continue to focus on saving the euro and finding a way out of the debt crisis. Connecting economic interests with strong defence capabilities will continue to fall beyond the EU's radar.

However, the number of security challenges is likely to be vast in 2012. The EU will need to develop an active security and development strategy in Libya. Iran and its nuclear proliferation aspirations merit growing concern. The situation in Syria worsens. Meanwhile, new crises could break out in 2012 due to security threats in the South Caucasus and the Middle East, and intensified conflicts in the Horn of Africa. The EU will also need to prepare for NATO troop withdrawal from Afghanistan post-2014 and start taking the necessary measures to become a relevant player in the broader region.

Europe does not see its security and defence policy as a tool to shore up its declining but still substantial economic power. Hard military power is not the primary answer to global challenges, but it is an essential ingredient. The challenge in 2012 will be how further to develop an effective CSDP with clearly defined objectives that dovetails far better with broader European development and foreign policies, including economic and trade aspects.

Europe's lack of ambition

The European public's threat perception is low and the population shows little interest in European defence. EU governments are increasingly turning inwards and defence budgets are being cut across the board. Little attention is devoted to strategic thinking on Europe's hard security position in the world.

Europe lacks unity and the ambition to turn the CSDP into a meaningful hard security actor. So far, the EU has been unable even to agree on the establishment of a CSDP operational headquarters. The United Kingdom has blocked this and hesitant member states lack the ambition fully to support the large member states – Germany, France, Poland, Italy and Spain – that do seek to enhance CSDP's operational capacity. High Representative Catherine Ashton has spoken in favour of an operational headquarters and in 2011 undertook a CSDP evaluation; this has not been made public, mainly on the request of the UK that is reticent of being seen as blocking all CSDP developments.

Meanwhile, the EU Battlegroups system is unlikely to develop into a larger 'standing army' for Europe. In 2012, the rotation system – in which member states assume responsibility for forming a Battlegroup for six months – might even be scaled down. So far, no member state has volunteered to take care of a Battlegroup in the second half of 2012. Governments feel that the system, which has still not been used, is expensive to coordinate and prepare, while most EU member states struggle even to contribute to NATO's Response Force.

The CSDP will not be a primary instrument of EU power projection, but could still be an essential tool of post-conflict reconstruction and development. The current 13 CSDP military and civilian missions are mostly small in scale, except for the military mission in Bosnia and Herzegovina and the civilian mission in Kosovo. Small missions tend to monitor peace agreements (Georgia) or to support security sector reform (Democratic Republic of Congo). So far, the EU's only geo-economically motivated military operation is the naval operation Atalanta, in force since December 2008 to counter piracy off the coast of Somalia. No new missions are foreseen for 2012. Overall, member states opine that CSDP missions cause too much bureaucratic hassle and garner meagre results.

In 2012, the debt crisis and the possibility of a two-speed Europe will put CSDP development on hold. In the worst-case scenario, the euro crisis might turn out to be the first nail in CSDP's coffin. Whereas a two-track Europe will initially apply to economic integration, it will also have a severe impact on other policy fields, including defence. A split between Eurozone countries and the rest could eventually lead to a similar division within the CSDP; this may become apparent as early as 2012.

France, Germany and the UK have already disagreed on defence in recent years. In any future divide, a CSDP without the UK's input would be largely irrelevant. Germany was unwilling to participate in the

UN-mandated intervention in Libya in 2011 and is unlikely to change its anti-militarist stance in 2012. France is disappointed over the lack of unity regarding European defence integration and increasingly prefers to follow a national defence approach. With no CSDP development in sight, member states increasingly look towards bilateral defence cooperation arrangements, such as that concluded between France and the UK.

The US is unhappy with European defence efforts. Washington has long pushed Europeans to invest in defence and now has stepped up its campaign, by advocating a further CSDP build-up. Washington has urged an increase in burden sharing and has insisted that Europe needs to be able to take care of its own defence. This is due to the US's strategic shift from an Atlantic to an Asia-Pacific mode of strategic thinking. Washington struggles to maintain its current level of engagement, and its international commitments are expected to diminish across the board in 2012, particularly due to budget cuts and an increased focus on domestic questions during next year's presidential campaign. Still, the gap between US and European capabilities continues to grow and this is unlikely to change in 2012.

For Europe to remain a prominent international player it does not need massively to increase defence spending or turn the CSDP into a military deterrence instrument in the traditional sense. In fact, the economic crisis might provide an opportunity to do better with less, by demanding more systematic coordination and integration with other EU policies. In addition, the EU should examine which interests are realistic, essential and shared by all. These should be highlighted in a new and more focused European Security Strategy (ESS), which incorporates relevant fields such as foreign policy, energy, trade, development and values, clarifies the use of tools such as sanctions, and takes into account the new Lisbon mechanisms. A broad ESS could also draw on NATO's 2010 Strategic Concept so as to avoid overlap where military matters are concerned. The current strategy was approved in

2003; if revision begins in 2012, a new ESS would be ready ten years after the first strategy in 2013.

In 2012 and beyond, three broader engagements should be a priority for Europe's security and thus geo-economic outlook: taking a broad approach to security; strengthening the EU's neighbourhood policies; and reinforcing defence cooperation, including contributions to NATO.

Essentials for European defence and security

First, Europe needs to fine-tune the balance between hard and soft security interests. In the global list of defence spending, there are still six European countries in the top 20. However, Europe still depends on the US, as seen in the NATO-led Libya campaign. A robust CSDP in traditional security is not a panacea to safeguard geo-economic interests. China and India, for instance, are regarded as rising for their economic growth, not for the strength of their armed forces.

If deep CSDP integration on hard security and increased defence spending by member states is not a realistic option in the coming years, the CSDP should at least further refine its soft, mixed civilian-military security component. This implies CSDP being more firmly nested in broader European external policies. For this to happen, the new Lisbon arrangements need to be further developed and adapted. The European External Action Service (EEAS) and the CSDP need to integrate further beyond the position of the High Representative. Divisions and turf fights between external policy (EEAS) and development funding (EuropeAid) need to be remedied. A situation where external policy does not run parallel to funding seriously undermines Europe's capacity to act as a coherent actor.

This will be of particular importance for the EU's presence on the ground. Currently, the EU's special representatives, the delegations, the

Commission-driven assistance programmes and CSDP missions often function as separate islands. This is not only confusing to partners but also ineffective in consolidating a European geo-economic stance.

Second, Europe is directly affected by insecurity in its neighbourhood. Concerns vary from migration flows to macro threats such as instability and civil war in neighbouring states, as well as potential inter-state wars between neighbours. The Arab spring provides an opportunity for Europe to get the link between security and democratic development right this time around. In 2012 the EU must go further in its revision of the European Neighbourhood Policy (ENP) – including the Union for the Mediterranean – so as to go beyond development assistance and trade provisions to build reform-oriented security ties with partners. Differentiating among partners is essential and this should supersede regional cooperation initiatives.

Eastern Europe and the South Caucasus are also crucial to Europe's security – the former due to energy relations, the latter due to both energy and security concerns. The unresolved conflicts of Georgia and Nagorno-Karabakh between Armenia and Azerbaijan should rank higher on Europe's security agenda. Tensions over Nagorno-Karabakh remain particularly high and could seriously destabilise the region, which would in turn affect energy flows to Europe.

For Europe to have an impact in the south and the east, a bolder approach towards Russia and Turkey, crucial actors in the neighbourhood, is needed. Turkey is rapidly rising as a geo-political actor and so is its influence, from North Africa to Central Asia. In 2012, instead of paying too much attention to stalled membership negotiations, the EU and Turkey should pursue joint action in the neighbourhood, especially in the Middle East and North Africa. As for Russia, Moscow is vital to solving Europe's unresolved conflicts in Eastern Europe (Transnistria in Moldova) and the South Caucasus. Building a frank but geo-political relationship with Moscow should be amongst the EU's priorities in 2012, especially after the presidential elections, in which Vladimir Putin is expected to take the reins of the country once again.

Third, European security is and will be subject primarily to national defence arrangements and NATO. The US is increasingly looking towards Asia; to keep NATO strong, while the Alliance is suffering from the same Western decline as CSDP, it will have to become more European.

NATO is likely to remain the backbone of European defence. It has the track-record and the experience to deal with hard security matters. The transatlantic link with the US will remain crucial economically, politically and hence militarily, and the inclusion of Turkey as a key regional power connecting Europe to the Islamic world is essential. The NATO summit to be held in Chicago in May 2012 will test the relationship between free-riding Europeans and defence hardware obsessed Americans. Europeans will have to show some proof of their 'pooling and sharing' efforts in NATO. Hopefully, the Ghent initiative, under which European defence ministers coordinate pooling and sharing of military capabilities, will bring meaningful results. The December 2011 Council meeting of defence ministers further agreed on 11 cooperation proposals out of more than 200 initial plans, plus a German-Swedish food for thought paper on military cooperation. 2012 is likely to see a larger conference discussing Ghent-driven cooperation plans as well as bilateral and regional defence cooperation initiatives.

Strengthening current policies

Europe has several mechanisms at its disposal to defend its declining but still substantial economic power in the world. But these do not relate mainly to EU security and defence structures. The combination of CSDP soft security with member state and NATO hard security is likely to remain the only game in town. There is nothing drastically wrong with this situation as long as the EU and NATO start talking and coordinating. This also applies to the still substantial though declining defence capacities of individual member states that need to be ready to contribute to a military coalition in time of need.

Europe's defence and security narrative must be developed further, beginning by initiating the debate on a new European Security Strategy in 2012. The CSDP cannot be defined in strict military terms and there is no political will to follow the trends in US defence spending. Europe will need increasingly to incorporate security provisions into its extensive programmes and partnerships that so far have focused mostly on development and trade policies. The neighbourhood, including Russia and Turkey, remains essential here.

Security and defence is just one part of the broader puzzle for Europe to manage decline. Excessive military spending or deep CSDP integration will not necessarily guarantee the current level of economic welfare. Europe's strength lies in the human aspect of security. A human security approach, in combination with extensive security cooperation through different global and regional mechanisms, remains best suited to safeguard Europe's geo-economic interests. Defence will continue to lag behind geo-economics in 2012. But in an era of resource constraints, the EU will need to start delivering on its long-existing promise to narrow the divide between the security and economic dimensions of its external relations.

4. A geo-economic Germany?

Kristina Kausch

Germany has increasingly projected power abroad through economic means. Over the past decade, it has done so in pursuit of narrow national economic interests, disregarding the potential impact on its international competitors. Although this follows a Europe-wide trend of a tighter focus on bilateralism and a stronger economic lead in foreign affairs, it is a policy direction that is particularly marked in Germany. Hans Kundnani labels Germany the 'purest example of a geo-economic power in the world today'. This trend will undoubtedly continue in 2012, although Germany will also be called upon to demonstrate more enlightened and self-effacing leadership within Europe.

Export, export, export

Germany's greater focus on economic tools in its external action has been a logical consequence of the country's increasing export dependency, which intensified following the introduction of the euro. German geo-economics has been particularly pre-eminent since the Schröder government came to power in 1998. Gerhard Schröder implemented unpopular labour and tax reforms and took large business delegations on his trips abroad. Unlike his foreign minister Joschka Fischer, Schröder was especially criticised for pursuing stronger economic ties with

Russia and China while ignoring the human rights situation in these countries. As is well-known, after leaving office, the former chancellor controversially took up a lucrative position on the board of the Nord Stream AG, a German-Russian gas pipeline that Schröder had promoted while in power.

Under Angela Merkel, Germany's geo-economic focus has continued, especially in the wake of the financial crisis. According to *The Economist,* Guido Westerwelle is Germany's 'least popular foreign minister on record, partly because he seems more passionate about taxes than foreign affairs'. Germany's effort to export its way out of the crisis is currently driving its external relations. Germany is the world's second largest exporter after China and the fourth largest economy after the United States, China and Japan.

Due to its dependency on global markets to sell its exports, Germany was initially hit by the crisis much more heavily than most other Eurozone countries. But over the last two years, the German economy has enjoyed its greatest boom since reunification. With a 3.6 per cent economic expansion in 2010, the country enjoys the highest growth rate in Western Europe, and prospects for 2012 are favourable. German companies have even profited from the latest round of the crisis, as investors have withdrawn funds from fragile southern Europe to reinvest in calmer northern waters.

Germany's increasing focus on strategic partnerships with key economic partners China, India and Russia continues under the Merkel government. While the European Union's common market still absorbs two-thirds of Germany's €800 billion annual exports, no other segment of German foreign trade is growing as quickly as commerce with China, which increased by 60 per cent in 2010. Transactions with Germany account for almost 30 per cent of China's trade with the EU, worth $140 billion in 2010 (approx. €105 billion). Experts agree that Germany owes its current boom largely to Chinese demand. Over the past few years, German companies have been lobbying the government to promote their interests more actively in relations with China, as did Gerhard Schröder in the past. At the same time, Germany's export industries are increasingly concerned that German dependency on Chinese markets may make them vulnerable to Chinese power politics. Business leaders complain about Chinese attempts to link their investment decisions to technology transfer. Tensions between Berlin and Beijing following Merkel's reception of the Dalai Lama in 2007 are largely forgotten. Criticisms regarding China's human rights record are still present, but are barely audible and likely to remain so in 2012. Chinese government delegations now receive such a warm welcome in Berlin that some German newspapers decry a relationship that 'demonstratively prioritises economic interests'.

More recently, some German corporate bosses have begun to complain about Berlin's lack of business spirit. Business leaders were furious with the government's decision in the wake of the Fukushima catastrophe to withdraw entirely from nuclear power by 2022, increasing the prospect of rising electricity costs. However, considering Germany's pioneering role and heavy investments in the renewable energy industry, and its position as one of the world's leading producers of wind turbines and solar energy technology, the decision could easily prove to be a strategic move to benefit German business in the long run.

Contrasting dynamics in the Middle East

In Europe's neighbourhood, Germany's response to the Arab spring was initially hailed for its early nominal support to pro-democracy protesters. But this was soon eclipsed by serious criticism of Germany's shoring up of repressive autocratic regimes in the Arab world through heavy arms sales. In the past five years, Germany's arms exports have more than doubled, making it the world's third biggest arms exporter after the US and Russia, with a share of 11 per cent of the global market.

In order to challenge increasingly fierce global competition, the German government has reinforced efforts actively to foster arms exports. In 2011, the Merkel government effectively loosened restrictions on arms sales that were introduced under Schröder in 2000. According to former development minister Heidi Wieczorek-Zeul, the sole goal is to 'export, export, export'.

Amnesty International has said that between 2005 and 2009 the German government approved arms exports to Egypt, Bahrain, Yemen, Syria and Libya, amounting to €77 million. According to a German government report, the Middle East region bought German government-endorsed weapons and proliferation goods worth €1 billion in 2009 alone. Between 2007 and 2009, the German government approved sales of tear gas to Qatar, pepper spray and electric-shock gear to Saudi Arabia, and shackles to the United Arab Emirates (UAE). Both sides of the Libyan civil war fought with German, or partly-German, weapons and equipment. The water cannons used by Hosni Mubarak's regime to push back protesters in Egypt were of German production, although as of 4 February 2011 arms exports to the country were halted. At the height of the popular uprisings in the spring of 2011, the German government controversially endorsed the sale of 200 battle tanks to Saudi Arabia, one of the most repressive regimes in the region, which had deployed troops to neighbouring Bahrain to help crush protests only weeks earlier.

Germany's abstention from the United Nations Security Council (UNSC) vote on Libya in May 2011 was seen by many as a renunciation of the multilateral policies of former German governments. Germany chose to protect its immediate interests even at the cost of isolation from its traditional allies. Others interpreted it as an attempt to indulge Germany's firmly non-interventionist electorate. German aspirations to influence global governance, paired with a reluctance meaningfully to contribute to global security, have cast doubts over the way Germany aims to position itself internationally. Germany's traditional reluctance to use military force as a foreign policy tool, often underestimated by external observers, is deeply entrenched among the German public. Most Germans deeply embrace multilateralism as the only admissible framework for transnational relations and reject classical power politics. In spite of fierce internal debates on the issue over the past two decades, a shift away from the notion of Germany as a 'civilian' power is unlikely to take place in 2012.

Since the 1999 Kosovo intervention, however, the German public no longer excludes the use of military force as an exceptional multilateral means to prevent massive bloodshed. Recent polls revealed that 62 per cent of Germans were in favour of the use of military means to prevent bloodshed in Libya, but only 29 per cent wanted Germany actively to participate in such efforts. Ironically, facing criticism regarding Germany's stance towards the Libya intervention, German cabinet members implicitly accused their NATO allies of being motivated by economic greed. The Libya intervention illustrated that German post-war non-interventionism still outweighs German geo-economic considerations where these compete. Germany is not a country prepared to deploy troops for contracts.

Crunch time for German leadership

In the Eurozone crisis, Germany has largely played Scrooge. The German economy has benefitted greatly from the euro's depreciation in the wake of the crisis, which allows it to export at more competitive prices. Not surprisingly, this has prompted sharp criticism that Germany's new *Wirtschaftswunder* ('economic miracle') comes at the expense of its trading partners, in particular other Eurozone countries. French and US government representatives have criticised German export surpluses and the Merkel government's reluctance to stimulate domestic demand and meaningfully shore up the finances of ailing European economies. Germany's trade surpluses, critics say, mean that highly indebted countries are forced to borrow even more, and that Germany enjoys unfair competitive advantages from the weak euro at the expense of others. Suddenly, admiration for the German economic model seems to have given way to the image of an export-obsessed Germany lacking any spirit of European solidarity.

In the eyes of some observers, Germany's role in the crisis more recently seems to have changed from reluctant laggard to shining saviour. Following months of severe international reprimands, Angela Merkel was praised for her firmness and leadership in negotiating last minute key deals, and some begun to talk of a 'German Europe'. Merkel's U-turn to steer the Eurozone out of trouble may suggest that, while using economic means to project its power abroad, Germany ultimately remains committed to its traditional reliance on multilateralism and the EU project. However, it may just as well prove the opposite, given that Germany has most to lose if the Eurozone were to crash. In either case, branding Merkel's Germany as the ultimate geo-economic zero-sum player seems premature. German economic and European political interests converge. While driven by economic considerations, Germany's decisive push for 'more Europe, not less' as the answer to the crisis also attests to its continued commitment to EU strategic multilateralism as a win-win cooperation. The Merkel government may have understood that geo-economic and pro-European behaviour need not be in contradiction. In order to resist the tempest of global power shifts, geo-economic multilateralism, not short-term geo-economic bilateralism, will best serve German interests.

In sum, geo-economics appears indeed to have become Germany's leading foreign policy rationale. It is not, however, a 'pure' geo-economic player. A few dossiers still weigh heavier than economic considerations. As the case of Libya demonstrates, Germany's post-war non-interventionism still outweighs geo-economics in foreign policy decisions. Similarly, so far the primacy of the European project has been a supreme imperative for every post-war German chancellor. 2012 will provide an existential test of whether this is still the case today.

Key decisions in 2012

In 2012, a comprehensive Eurozone rescue deal will have to be shaped and implemented. This will require several EU member states to cede parcels of sovereignty. It will call for considerable statecraft and discipline from Merkel and her European partners. During this process, in order to reconcile geo-economics with visionary multilateral statesmanship, the German government will need to start seeing German 'sacrifices' as investments.

Angela Merkel will have to explain to German taxpayers, who still see the crisis as a marginal problem in the EU's southern periphery, why they have to bear the costs of Greek, Italian and Spanish mismanagement. Also difficult will be to convince them why the country is to accept EU integration when the benefits of the last round of EU constitution-writing are still unclear. These are likely to be among the greatest challenges for the German government in 2012. With general elections due in late 2013, the Merkel government has less than two years to win the hearts and minds of the population.

Closing the gap between the German electorate and the government will be crucial to secure the parliament's approval of key rescue decisions. In early 2012, the Bundestag will vote on the European Stability Mechanism, the permanent successor to the European Financial Stability Facility. Opposition against this and other future rescue measures are growing proportional to prospective German commitments for the Eurozone rescue packge in 2012.

Crucially for the subject of this volume, these challenges of the debt crisis will have ramifications for foreign policy. In 2012 Germany's export focus will increase in an attempt to recover lost ground while domestic demand slumps. Germany's relationship with China and other emerging Asian partners will remain overwhelmingly trade-based. However, with German-Chinese business links growing tighter and

Chinese businesses growing more assertive, squabbles over economic governance, regulation and the rule of law are likely to become more frequent in the year ahead.

In the Arab world, Germany will steer clear of any major involvement even when the Arab spring approaches crunch time in 2012. German military engagement in Iran, Syria or elsewhere in the region can be ruled out. In focusing largely on China and other emerging powers, Germany risks neglecting dramatic developments in its southern neighbourhood that will inevitably affect all of Europe. In this vein, it remains doubtful that Germany will assume the kind of political leadership consonant with its geo-economic dominance.

5. The UK, France and Spain: commercial diplomacy rising

Nika Prislan and José Ignacio Torreblanca

The Eurozone debt crisis and the rise of emerging powers such as the BRICS, has led to a slow but steady resurgence of geo-economics in the foreign policies of EU member states. This is not only true of German policies. Other European political heavyweights such as France, Spain and the UK have also begun to follow more geo-economic policies. This has been particularly so in these countries' dealings with the BRICS. Whether approaching Brazil, China, India or the Gulf, the neo-mercantilist tone has become more evident. But the price is high. EU member states have sacrificed cohesion and effectiveness for the sake of very meagre economic results They have also sent the message that unity is not a priority and that their principles, especially on democracy and human rights, are up for sale.

The result places Europe in the worst of two worlds. Despite their having broken ranks to try to reap individual benefits and free-ride each other, European countries' geo-economic strategies have failed to deliver. The EU has further weakened its image and credibility as a collective actor. The BRICS and other rising geo-economic powers wish that the EU would fix its problems collectively rather than have member states engage in bilateral deals.

The signs are not good that EU member states will learn this lesson in 2012, pressed as they are by the debt crisis. The year ahead will most likely be remembered as one of the most complicated years that key member states like France, Spain and the UK have ever had to face. These three member states have launched a frenzy of activity aimed at bagging investment deals; while these may have brought short-term gain, they are bereft of sufficient reflection on the cooperation needed to advance long-term interests.

Geo-economic foreign polices

Spain has been one of the countries hardest hit by the Eurozone crisis. This prompted prime minister José Luis Rodríguez Zapatero and his government (2004-2011) to shift to a more geo-economic foreign policy. Throughout 2011, Spain looked increasingly towards China to save it from its troubles. The visit of Chinese vice premier Li Keqiang in January 2011 resulted in contracts worth $7.5 billion (approx. €5.5 billion), as well as China's promises to buy Spanish sovereign debt. Only four months later, Zapatero visited China where he met with president Hu Jintao in another move to improve economic relations and promote further Chinese investments in Spain. This visit was Zapatero's fourth to China since he took office in 2004. The re-appointment of Ambassador Eugenio Bregolat for a third (non-consecutive) term as Spanish ambassador to China demonstrated that Spain's foreign ministry was not willing to take any risks when dealing with China, even if it meant breaking the long-standing tradition of not posting ambassadors to the same place more than once.

Spain's geo-economic offensive on China appears at one level to have paid well. According to vice premier Keqiang, Spain is China's 'best friend in Europe'. In 2009 and 2010, the 'Asia, Africa and others' group was the highest owner of Spanish debt with approximately 26-28 per cent, due to China's increased buying of Spanish debt. In return for Chinese support, Spain kept its traditionally low profile on China's human rights record. In 2009, the Spanish EU presidency called for the lifting of the EU arms embargo on China to the outrage of the US and its EU allies and Spain was the last EU member to congratulate human rights activist Liu Xiabao for his Nobel Prize in 2010.

Similarly, in 2011 Zapatero visited both Qatar and the United Arab Emirates in the search for new economic investors in Spain's weak economy. Zapatero was able to secure €150 million in the UAE and another €300 million in Qatar for the recapitalisation of Spain's saving banks, deeply affected by the collapse of housing prices following the financial crisis. He was also able to secure contracts for Spanish companies worth €1.4 billion in the UAE and a promise of €3 billion worth of investments in Spain by Qatar.

The Zapatero government was heavily criticised for focusing on these geo-economic oriented visits, while Tunisia and Egypt were moving towards democracy amidst the Arab spring. After all, Spain and the EU had supported the Ben Ali and Mubarak regimes. Spain also remained cautious over the lack of freedom in the Gulf region and the violent crackdown of protests in Bahrain.

In 2012, the recently elected centre-right PP (Spanish Popular Party) government will most likely further emphasise geo-economics in Spanish foreign policy. The foreign policy of the centre-left PSOE (Spanish Socialist Workers' Party) used geo-economics as a last minute resort to deal with the financial crisis. The PP will prioritise geo-economic mercantilism with more conviction from the beginning of its mandate. Contrary to the Socialists, the PP is well used to prioritising a business foreign policy. During the previous PP governments under José Maria Aznar (1996-2004) Spanish firms acquired multinational status worldwide, thanks to the combination of a secure euro and the growth of the Latin American economy. All the indications from recent speeches, interviews and policy documents are that the new PP administration under Mariano Rajoy will be tightly focused on economic matters, using diplomacy to advance the country's national economic interests, most intensively in Latin America, but also in other regions such as Asia.

In France, the deepening of the Eurozone crisis has also led president Nicolas Sarkozy to change his focus towards a more geo-economically led foreign policy. This move was facilitated by the opportunities provided by the 2011 G20 French presidency. The shift began in earnest in November 2010 when Chinese president Hu Jintao visited France in an attempt to improve the bad relations between the two countries. The boycott of the Olympic torch in its trip through Paris and the meeting between Sarkozy and the Dalai Lama in Warsaw had led to the boycott of Carrefour products and the cancellation of the EU-China summit during the French EU presidency in the second semester of 2008. But in 2010, the visit organised by Sarkozy to impress Hu Jintao and secure business deals for French companies resulted in commercial deals worth $20 billion (approx. €14.8 billion). Since then, Sarkozy has also pleaded China to aid the Eurozone's bailout fund.

Sarkozy's appeal to China after the Eurozone crisis and the Cannes G20 summit in October 2011 to 'invest' in an enlarged European Financial Stability Facility was seen with scepticism in Europe. Beyond concerns that China's economic aid might be in exchange for political concessions, it also raised other fears as France's financial problems were thus raised to the European level. France's triple A credit rating would be in danger if it were to put up more money for the EFSF, which could in turn lead to even greater turmoil in the Eurozone.

France's geo-economic stances were also evident during its hosting of the G8 and G20 summits in 2011. Although the results of these encounters were mediocre, Sarkozy's G20 agenda included issues such as correcting the imbalances in the international economy between surplus and deficit countries. As reported by the *New York Times,* Sarkozy initially called on the G20 to introduce 'changes to the international monetary system,

in a bid to reduce exchange rate fluctuations and give the euro and other currencies more status compared with the dollar'. France has sought to use its leverage within the G8 and G20 openly to defend its national interests, forcing Sarkozy to set aside his initial ambitions on global governance and the 're-founding of capitalism'.

France's geo-economic ambitions have caused rifts with Spain and other EU member states. One example was the deal to build a TGV high-speed train in Morocco, which was reached without open competition in 2007 when King Mohammed directly awarded the contract to France. When France asked for a European Investment Bank (EIB) loan to finance the construction, Germany voted against the petition as retaliation for Siemens not having been able to compete for the contract. France was finally given the green light with Spanish support. Such internal bickering between EU member states reflects the negative effect that geo-economic ambitions have on European solidarity.

French policy is set to continue in the same direction. Even if the Socialists win the 2012 presidential elections, the economy and the euro crisis will still dominate the agenda. There are no firm signs that the Socialists would change direction and adopt a less mercantilistic external policy. Only if the euro crisis ends in a solid fiscal union and market pressures abate is France likely to engage in a more broadly cast foreign policy.

The UK government has also moved towards a more geo-economic foreign policy. In July 2010, less than three months after becoming prime minister, David Cameron visited India, accompanied by 39 top executives from British companies, the largest UK trade delegation in living memory. David Cameron wanted to reorient British foreign policy to serve the British economy, in contrast with the more traditional diplomacy of the Blair-Brown years. In India, Cameron secured a €840 million deal for the UK to supply India with 57 Hawk trainer aircrafts. For the British premier, this was 'evidence of our new, commercial foreign policy in action'. It was not by chance that UK foreign secretary William Hague chose Tokyo to deliver a landmark speech about 'Britain in the world', completing the turn towards a more geo-economic foreign policy. Hague called for a more trade-oriented Foreign and Commonwealth Office, re-energised bilateral relationships and a more proactive policy on global governance. The government has made it clear how little trust it has in the EU as a vehicle to advance Britain's external economic interests.

Similarly, the visits by Chinese vice prime Minister Li Keqiang in January 2011 and prime minister Wen Jiabao in June 2011 both resulted in large deals for UK companies. In January, PetroChina signed a multi-billion pound agreement with Ineos, as well as £2.6 billion (approx. €3 billion) in other deals, while in June deals worth another £1.4 billion (approx. €1.6 billion) were agreed upon.

The most important aspect of the UK's change towards more commercial diplomacy is directly linked with the deepening of the Eurozone crisis. While the UK has not experienced exactly the same problems as its Eurozone partners and did not need to turn to emerging economies for help, it is clearly turning away from Europe towards other economic partners. In 2012 this will begin to strain and weaken the UK's relationship with the EU. British self-isolation from the EU could also accelerate the UK's economic marginalisation by its EU partners, on top of the political marginalisation to which it has already been submitted. The economic advantages of trading with EU partners were always the main attraction for the UK of Union membership; the EU remains the main source of its exports and thus wealth.

Blinkered thinking

The rise of geo-economics in the national foreign policies of EU member states represents a dangerous evolution for the EU's long-term interests. First, an increase in geo-economics tends to nationalise rather than Europeanise foreign policies, decreasing the chances of success for a common European foreign policy. Furthermore, the increase in the importance of commercial policy in national stances may lead to clashes among EU member states. More aggressive commercial diplomacy increases the probability of states competing for the same foreign partners and deals. The UK, France and Spain are all vying for China's attention. The eventual emergence of a so-called 'logic of conflict' from the 'methods of commerce' may lead to a tearing of the economic and policy links that so tie EU member states together.

This greater nationalisation of commercial policy in EU member states and the concomitant greater importance of national economies runs contrary to EU members' real interests. The economies of the UK, Spain and France are individually much smaller than that of China, are growing at a much slower pace and have decreasing populations. They will have much less to offer to the emerging economies than would a united European economy. EU member states' increase in national commercial diplomacy and quick fixes in the short run will damage their prospects in the long run.

On the other hand, one can see why EU member states have been pursuing such national policies. Outflows of foreign direct investment (FDI) declined 62 per cent from 2009 to 2010, while inflows decreased even more, by 75 per cent. Out of the three countries covered here, only the UK was a net recipient of FDI in 2010 (almost three quarters of inward FDI to the UK came from the US). Spain's outward FDI flows to China totalled €1.4 billion (out of €7.9 billion). France's was similar to Spain's in amount, but smaller in the total percentage it represents due to higher FDI outflows. These figures help explain French, Spanish and British geo-economic tactics.

Nevertheless, the Eurozone crisis is fuelling a vicious circle that will damage the prospects for EU member states in the long run. Based on the cursory yet illustrative commercial examples offered above, it is clear that the Eurozone crisis is prompting countries to adopt individual geo-economic approaches, which are diverting them from European solutions. National approaches are not prepared to provide effective solutions in the face of 'high speed' globalisation. Only the combined action of the 27 EU member states will have sufficient economic power to compete with emerging powers.

The geo-economic ambitions of EU member states and their apparent lack of European solutions to the re-nationalisation of foreign policies have been heavily criticised. 2012 will certainly be a challenging year for the EU, in terms of not only solving the Eurozone crisis but also finding joint European solutions to national issues. The case of China is an example. China is highly decisive for the EU's future and there is an urgent need for the EU to show political unity and follow concrete and united European policies towards the Asian giant. Ideas that should be considered in 2012 include a coordinated system for government debt purchases, a system for vetting direct investment and fair competition in public procurement. Such policies on a Union level would not only decrease EU divisions over China, but also rein in EU member states' geo-economic ambitions.

The G20, of which the UK, France and Spain are members, should be an important forum also for the EU as a whole to negotiate and balance the various geo-economic ambitions of its member states. If the EU were to take a more unified stance and unite its economic external representation in the G20, the IMF and other international institutions in 2012, this could diminish the negative side effects of some foreign powers' geo-economic policies.

An effective and sustainable solution to the Eurozone crisis is urgently needed. This would decrease the pre-dominance of national commercial diplomacy, as EU member states would have less need for geo-economically centred foreign policies. The key in 2012 is a further push towards more economic and political integration in the European Union.

6. Asia as a geo-economic hub

Gauri Khandekar

In the wake of the financial crisis, EU member states have been proactive towards Asia. But the EU's overall approach has been weak, mired by incoherence and a lack of coordination and far-sighted strategy. It has been unable to adapt its economic, political and security policies to the extremely vast and diverse Asian continent. The bloc as a whole continues to punch below its weight. And Asia will no longer be there so easily for the taking. The continent is reintegrating and Europe will now have to compete for Asia with Asia itself. Data from the World Trade Organisation indicates that in 2010, the majority of global trade flows were intra-regional. In all, 53 per cent of Asian trade was directed towards Asia. This trend will continue in 2012 and beyond. As the continent registers increasingly higher growth rates, Asia will be progressively harder to penetrate. Europe's Asian policies will need to change gear in 2012 if the EU is to avoid further marginalisation from the world's most dynamic region.

The EU's geo-economic take on Asia

EU member states have made strong individual efforts to advance their interests in Asia. But these have contributed little to the interests of the

European Union as a whole. Bilateral agendas continue to override a common approach and the EU's own performance remains feeble.

In June 2011, the UK signed a £1.4 billion (approx. €1.6 billion) deal with China. Earlier in November 2010, the two countries had already signed a £750 million (approx. €872 million) Rolls Royce deal. Since then, British exports to China have risen by 20 per cent. British prime minister David Cameron has indicated that he wishes to reach the target of $100 billion (approx. €74 billion) in bilateral trade by 2015. Around 420 Chinese firms have established themselves in the UK. Britain attracted 51 investment projects in 2010 and another 40 in 2011.

French president Nicolas Sarkozy also managed to secure Chinese premier Wen Jiabao's promise to designate Europe as a major investment market. Sino-French trade is rising at 30 per cent a year and reached $44.8 billion (approx. €33.2 billion) in 2010. Sarkozy travelled to Beijing twice in 2011 alone. China is France's tenth largest foreign investor with $1.5 billion (approx. €1.1 billion). In turn, France has over 4,000 business projects in China.

As for Germany, in Hamburg alone 360 Chinese businesses have been set up. During premier Wen's visit to Berlin in June 2011, China and Germany signed 14 new agreements worth $15 billion (approx. €11 billion). China has now become Germany's favourite destination for foreign investment. Beijing is Berlin's third largest trading partner and second largest destination for machinery exports after the US. One in four Volkswagen cars is sold in China. And China is attracted by Germany's high-tech know-how.

EU president Van Rompuy's visits to China fade in comparison. The cancellation of the EU-China annual summit in 2011 further reduced the EU's attractiveness as a partner. In fact, it is France, China's fifth largest trading partner in Europe, not the EU *per se,* who is leading talks with Beijing on EU sovereign debt purchase.

In the case of India, the EU still struggles to conclude its five-year long negotiations on a trade and investment agreement. Its political presence remains weak and neither high representative Catherine Ashton nor president Van Rompuy travelled to India in 2011. The EU as a whole remains divided on India's single biggest multilateral ambition: a seat at the UN Security Council. New Delhi disagrees with the EU's joint stances towards Pakistan, counter-terrorism and nuclear energy cooperation. Meanwhile, the UK, France and Germany not only secured billions of euros in deals, but also openly criticised Pakistan's stance on terrorism and underlined their bilateral support for an Indian seat at the UNSC.

In July 2010, David Cameron led the largest ever delegation to India in recent times, securing billions of pounds in bilateral contracts. During Indian finance minister Pranab Mukherjee's London visit in July 2011, another $7.2 billion (approx. €5.3 billion) investment accord was signed, the single largest foreign investment in India. According to British finance minister George Osborne, 3,000 British firms have major investment plans in India. Britain's Department for International Development (DfID) has allocated £1.2 billion (approx. €1.4 billion) in development aid to India from 2011 to 2015. In contrast, the EU has provided only €210 million for 2011-2013.

During president Sarkozy's visit in 2010, France and India signed seven agreements, including a $9.3 billion (approx. €6.9 billion) deal to build two pressurised reactors. France is the fifth largest arms seller to India. India has earmarked a budget of over $112 billion (approx. €83 billion) in the next six years to renew or upgrade military equipment. Under a $22 billion (approx. €16 billion) project, French state nuclear company Areva will supply six third-generation pressurised water reactors to India. Nuclear energy cooperation remains strictly bilateral. The EU-India Fission Agreement has remained stalled since 2009. President Sarkozy also underlined his wish to triple French scholarships to Indian students; there has been no mention of similar EU scholarships.

Similarly, during her visit to New Delhi in 2011, chancellor Merkel signed four pacts in the fields of education, research and nuclear physics.

Other Asian countries complain about the lack of EU attention. ASEAN leaders have been waiting for a high-profile EU visit since that of Commission president Barroso to the region five years ago. Germany has provided Vietnam with over €1 billion for Official Development Assistance (ODA) projects in the last two decades. In a visit to Hanoi in 2011, chancellor Merkel pledged additional funds for Vietnam. Currently, over 200 German companies operate in the country. The UK too sees Vietnam as a high growth market. Britain is the seventeenth largest foreign investor in Vietnam, with $2.5 billion (approx. €1.5 billion) in 2010. UK officials expect corporate investments to reach $3 billion (approx. €2.2 billion) by 2013.

The UK was the second largest investor in Indonesia in 2010, with a total of £439 million (approx. €511 million) in exports and £1.3 billion (approx. €1.5 billion) in imports. On a recent visit to Indonesia, French prime minister François Fillon vowed to double bilateral trade volumes in the next five years from the current $2.5 billion (approx. €1.5 billion). David Cameron recently extended £446 million (approx. €519 million) in development aid to Pakistan over a four-year period, making the country the largest recipient of British aid by 2015.

Despite member state geo-economic and development activities in Asia, the EU has been unable to harness these relationships and its own instruments to pursue a common interest in the continent. Member states increasingly compete against each other with only a very 'thin' set of EU Asia policies to bind them in harmony. A common strategy is conspicuously missing. There is no clearly identified common foreign policy direction. The EU continues to remain aloof from Asia's rising security concerns. In 2012, member states must recognise the EU's main attractiveness to Asian states: its strength as a 27-nation bloc and single market.

Geo-economics in Asia's reintegration

In the new world order, the EU's geo-economic power will have to compete with that of Asia. In 2012, as consumer demand continues to fall in Europe, the growth in intra-Asian commerce led by China will be more notable. Asian nations will start to explore closer integration within the neighbourhood through trade, investment and financial transactions. India's continued rise, FTA-champion South Korea and a remerging Japan will further fuel this pattern.

Overall EU trade figures in Asia are promising. The EU is the leading trade partner of ASEM as a bloc, accounting for 13.3 per cent of total trade. Individually, the EU is the largest trade partner of Pakistan, India, Bangladesh, Sri Lanka and China. However, China is quickly gaining ground. Today, China is amongst the top five trading partners of every Asian ASEM member. Other top partners are mostly Asian too: Japan and Singapore follow China closely.

In policy terms, the EU is yet to emerge as a powerful economic entity in Asia. Its sole free trade agreement (FTA) in the region is with South Korea (signed in October 2010). The EU-India FTA is still uncertain and individual FTA efforts with ASEAN member states further delay inter-regional trade liberalisation. In contrast, bilateral FTAs within the Asian sub-region have increased markedly in number. There are currently 245 FTAs either proposed, under negotiation or concluded in Asia. In 2012, the EU will have to confront this trend far more effectively.

The FTA with India should be the EU's main economic priority in the year ahead. According to HSBC, India's trade will increase by 156 per cent by 2025 to around $1 trillion (€742 billion), the highest growth of any country's trade. India is slated to become the world's third largest economy by 2050. As India continues to diversify its relations, the Middle East (in particular the UAE and Saudi Arabia), China and Latin America are likely to overshadow the EU and the US in its trade interests. A political conclusion on the FTA at the EU-India summit in February 2012 in New Delhi could save the EU-India relationship.

Japan will be eager to correct the disparities created by the EU-South Korea FTA and reinvigorate its own growth through a high-profile free trade agreement. After delays in 2011, a strong political push will be necessary at the EU-Japan summit in 2012 to begin negotiations.

Key considerations in 2012

In 2012, India and China will displace all other commercial leaders. Despite border disputes and the Tibet issue, the two neighbours are set to become each other's leading trading partners by 2030. In 2010-2011, Sino-Indian bilateral trade grew 68.8 per cent to $19.6 billion (€14.5 billion). This figure is expected to rise to $100 billion (€74 billion) by 2013. China is amongst India's top five trading partners accounting for 11.4 per cent of the latter's trade, not far behind the EU's 15.6 per cent.

In 2012, the EU will continue to urge China to invest in sovereign debt purchase. But China, which currently holds around 60 per cent of the world's foreign reserves, will be unwilling to jeopardise its investments in risky bonds. It will bargain for market status in exchange for a few billions in investment. At the EU-China summit in 2012, the EU must show itself more politically united on this issue. Gaining China's confidence will generate global credibility for the Union.

While Japan too has signalled its willingness to purchase Eurobonds and invest in the European Financial Stability Facility, the EU will have to come up with concrete proposals in 2012. Asia has put greater emphasis on a stronger IMF role instead of direct investment, in the hope of strengthening its own position in international financial institutions. The EU must decide how it can dovetail with Asia's reform agenda.

Traditional rivalries seem set to subside in 2012. The EU is today Pakistan's leading trade partner with 15.8 per cent (€7.1 billion) of the country's trade, but may be soon rivalled by closer Indo-Pakistani ties. Islamabad has decided to accord the status of most favoured nation to India. Greater economic proximity could further minimise tensions and exponentially increase bilateral trade between India and Pakistan.

In Northeast Asia too, Asia's geo-economic reintegration is booming. In 2012, regardless of the outcomes of the presidential elections in Taiwan, Beijing is unlikely radically to alter its policy towards Taipei. It is likely that current president Ma will continue into a second term. Beijing will aim for bilateral agreements to supplement the fifteen accords currently signed. In 2012, the EU will have to decide how it will upgrade its own trade relations with Taiwan as Taipei reiterates its demands for an FTA.

In Myanmar, fellow ASEAN partners increasingly support the ex authoritarian regime and the EU seems keen cautiously to encourage the limited political opening witnessed in recent months. In 2012 and ahead of the country's likely ASEAN chairmanship in 2014, the EU will need to reconsider its entire stance towards Myanmar. While a firm stance should be maintained on the country's human rights abuses, the potential window of opportunity to engage on reform should be seized in 2012.

The EU must begin to engage on Asia's rising security concerns. Maritime security is of paramount concern in Asia-Pacific geo-politics. The EU must decide whether and how it will partner with the US, China and ASEAN on this question. The ASEAN Regional Forum is the main venue where deliberations take place, but the EU failed to attend in 2011. In 2012, high representative Ashton's presence at the forum will be decisive for the EU's credibility in the region. Similarly, the EU will have to decide on what terms, if any, it will accept to join in anti-piracy efforts in the Straits of Malacca.

The ninth ASEM summit in Laos in November 2012 will be a challenge for the EU. It must reinstate confidence among its Asian partners that it is committed to the region. This will in turn be crucial for the EU to be accepted into the East Asia summit, which opened its doors to the US and Russia in 2011.

The EU must also seek more visibility on nuclear safety issues in Asia. The International Nuclear Security Summit in March 2012 in Seoul can provide the appropriate platform for the EU to address its concerns on Asia's rising security challenges. In particular, as instability will continue to grow in Pakistan, the EU must increase its cooperation with the Pakistani leadership to ensure the security of the country's nuclear arsenal. In 2012, the EU must also seek to enhance consultations with its strategic partners and six-party talk members (China, US, South Korea, Japan, Russia) on the North Korean nuclear issue.

In light of NATO's withdrawal from Afghanistan in 2014, the EU should devise a policy to fill the vacuum left by the US. The EU cannot falter on its presence in this part of the region, which is also vital for its own security. Cooperation with all concerned regional actors as early as 2012 is desirable. The EU must initiate foreign policy dialogues with all regional actors, especially Afghanistan's four nuclear-armed neighbours.

Europe's geo-economic future in Asia

In short, European political engagement needs to be ramped up alongside member states' purely commercial diplomacy. Europe's overall geo-economic performance in Asia has been weak. While individual member states' geo-economic policies in Asia are on the rise, the EU's potential as a whole remains untapped. EU economic interests in the continent need to be reinforced with greater political commitment. In particular, European security efforts must keep pace with Asia's rising concerns.

A clear Asia strategy, together with an increased political presence in the continent's forums, is essential to improving the EU's position. An integrated Asia will be of much more strategic advantage geo-politically, culturally and demographically, in terms of market sizes and consumer demands, as well as dynamic growth. Asia is one of the world's largest geo-economic hubs and could be the springboard to help the EU recover from its crisis and uncertain status in the new world order. But, the EU will need to fashion a far broader strategy in 2012 if it is to grasp this opportunity.

7. New opportunities in the Middle East?

Ana Echagüe and Barah Mikail

In the Middle East, the European Union has to contend with not only the economic crisis but also the uncertainty unleashed by the Arab revolts. The uprisings have deepened the economic divide between the economies of North Africa and those of the Gulf states. North African countries are suffering from decreased consumption, fewer exports and in some cases a halt in international transactions. While these factors are not expected to improve in 2012, in the Gulf region trends are back on the upswing. High oil prices have seen the revival of the economy and demand is on the rise. Notwithstanding a raft of new policy initiatives, the EU still underplays the Middle East's economic potential. In 2012 it will need to improve its engagement on the political factors that condition the region's economic opportunities and risks. After the initial excitement of the Arab spring the EU will need to show in 2012 that it is capable of following through on its new policy commitments. The way it does so will determine the still-shifting balance between economic and political interests within its Middle Eastern policy.

Uncertainty and stagnation in North Africa

While North African states were initially sheltered from the economic crisis by virtue of their limited international financial integration, they eventually suffered the effects of the decline in external demand and revenue from trading partners. There was a drop in tourist flows, exports to Europe, migrant transfers and foreign investment. Nevertheless, GDP growth remained positive and on average 2 to 3 per cent higher than in neighbouring countries in the northern Mediterranean.

Then, at the beginning of 2011, the Arab revolts led to increased uncertainty. High inflation and weak currencies undercut imports. Agencies dropped the ratings of the countries concerned, making access to finance more costly. International businesses were caught between scaling back and anticipating new business under the changed political situation. Initially, several large foreign companies repatriated their personnel (Lafarge and Orange in Egypt) or suspended production (Nestle).

Despite the uncertainty, the EU and its member states are focusing on the potential for trade and investment as a means of pulling the Arab countries out of their economic stagnation. The use of aid and preferential trade to tackle foreign policy issues is standard fare for the EU, but the Arab spring has led to a qualitative increase in the focus on trade and investment. High Representative Catherine Ashton has focused on trade as the prime incentive for the region, offering lower tariffs and greater market access to countries that deliver good governance and democratic reforms. The European Commission is due to present draft mandates for the negotiation of agreements on Deep and Comprehensive Free Trade Areas with Egypt, Jordan, Morocco and Tunisia. The EU is also focusing on investment agreements. It hopes that by providing soft loans from the European Investment Bank foreign companies can be encouraged to invest in the region. Member states are also gearing up to promote investment, couched in language of support for those who rose up against the dictatorships.

Aid, trade and investment

Relying on trade to shape policy in the region yielded meagre results during the first fifteen years of the Barcelona process. While there have been some positive, albeit modest, effects in terms of trade, politically the EU has suffered from the support it lent to the region's autocratic regimes. Of course, EU policies in the Middle East and North Africa (MENA) were always designed more for the benefit of the EU than that of its southern counterparts. The causal relationship between economic and political reform was taken for granted. What will be different in the context of the latest phase in EU policies? In 2012 and beyond, it is hoped that political change will result in healthier economies, broader consumer markets and increased business opportunities. Money, market access and mobility partnerships, the '3Ms', are more explicitly on offer. However, it is unclear how the EU will overcome its members' traditional protectionist instincts and whether they will be willing to buy into such a plan in the context of further budget cutbacks in the year ahead and current debates on border controls. In addition, caution is in order as the implications of the new governments and constitutions expected to be in place in Egypt and Tunisia in 2012 are still unclear. The continuity of existing economic models and openness to foreign investment are by no means a given.

In terms of aid, an additional €1.24 billion (and a total of €7 billion) have been allocated to the European Neighbourhood Policy (ENP) for 2011-2013. These include €250 million for the Facility for Euro-Mediterranean Investment & Partnership; €72.79 million for various regional transport, business and cultural projects; and €22 million for a Civil Society Facility.

The first meeting of the joint EU-Tunisia taskforce took place on 28 and 29 September 2011. EU financial support to Tunisia is expected to approach €4 billion over 2011-2013, including contributions from the EU, its member states and the EIB. Discussions have broached the liberalisation of trade to allow Tunisian agricultural and fisheries products into the EU, as well as industrial products and construction materials. €110 million are earmarked for economic recovery, €57 million to reform the water sector, €30 million to support EU university scholarships and €22 million to support civil society organisations. A €100 million grant will support the €1 billion multi-donor support programme SPRING (Support for Partnership, Reform, and Inclusive Growth). The EIB is expected to boost lending to Tunisia by 60 per cent. Over the summer, the EIB signed a €163 million loan to support road upgrades in Tunisia and a €140 million loan to help the Tunisian Chemicals Group build a fertilizer plant. In terms of support for economic and social reforms in 2011, the EU has topped up the €80 million originally allocated to a total of €130 million.

EU financial cooperation with Egypt foresees an allocation of €449 million over the period 2011-2013, which compares with the €558 million allocated for 2007-2010. This includes new Commission support of €22 million to increase income and create jobs for small and medium enterprises (SMEs). In 2011, €122 million were committed to assist in the areas of energy, social housing, trade enhancement and support to agricultural SMEs. Egypt is likely to be the first country in the region to benefit from the upgrade and expansion of the European Bank for Reconstruction and Development's (EBRD) financial assistance from Central Europe to the Middle East. An EBRD inspection team has already been to Cairo and from 2012 onwards similar consultations are planned for Morocco, Tunisia and Jordan (Libya might be included at some stage). The EBRD could end up lending up to €2.5 billion to the region annually. Egypt is also to receive about half of the €6 billion EIB funds for the region to 2013, followed by Morocco, Tunisia and Jordan.

In terms of trade, on the European side the elimination of distortions, especially with regard to agriculture and standards, will be key in the year ahead. While North African countries have a comparative advantage in agricultural goods, the opposition of EU Mediterranean countries has excluded them from further liberalisation. The Common Agricultural Policy (CAP) is an obstacle towards wider access by southern Mediterranean countries to European agricultural markets. Likewise, the service sector has not been open to these countries given the politically toxic theme of immigration. One often heard proposal is for the EU to expand its customs union with Turkey to include the Mediterranean states and extend its scope to include farm produce and services. This would simplify access to European markets by doing away with the myriad bilateral trade deals and rendering the complicated Rules of Origin certification requirements unnecessary. However, this presupposes progress on agricultural products and standards, which means addressing farm support policies. Trade in services would be the main source of future growth to be expected from the free trade area. However, this would require progress in terms of mobility.

In any event, lowering tariffs will be insufficient; funds will be needed to achieve the necessary *mise à niveau* and to minimise the social costs of free trade in the short term. Trade policy should not be conceived of strictly in terms of tariffs and non-tariff barriers. Key preconditions for furthering trade include good governance and an independent and functioning legal system, elements that were clearly not given sufficient attention in previous efforts to encourage economic reform and which will necessarily be county-driven.

Appropriate migration and foreign direct investment policies can also contribute to the further development of trade relations between the EU and MENA in 2012. FDI should contribute to future growth in the region and is expected to lead to technology transfers and the production of higher value products, as well as bolstering local SMEs through subcontracting. The revised European Neighbourhood Policy includes a focus on promoting a business and investment friendly environment by simplifying procedures and catering to small and medium-sized businesses, promoting employability, organising investors' conferences to clarify national investment priorities and enhancing investor protection. It is also exploring the possibility of providing additional support for SMEs with the EIB and other stakeholders through the European Investment Fund.

In terms of foreign direct investment, the upturn experienced during 2010 in the Mediterranean region was reversed during the first half of 2011 and is not expected to improve significantly in 2012. In 2010, half of FDI receipts came from European companies. The Gulf states, the US and other states (mainly emerging countries) each accounted for 15-16 per cent of FDI directed towards southern Mediterranean countries. Intra-Mediterranean investments stood only at 3 per cent. In the Maghreb, only Tunisia recorded a rise in FDI just prior to the political crisis. The Mashreq was stable after the withdrawal of Gulf investors in 2008. After the US and UAE, the top European investors were France, the UK, Spain, Germany, Italy and the Netherlands.

Europe is still the main source of FDI, accounting for 30 to 40 per cent of investments. In 2011, the number of FDI project announcements decreased by 23 per cent compared to 2010. Tunisia and Egypt in particular suffered severe drops of around 40 per cent in the number of FDI announcements for the first half of 2011. The announced amounts did not decrease in Tunisia even more thanks to oil and gas investors, notably Austrian OMV, Italian ENI and British BG. In Tunisia, however, lately the situation has started to improve. In Egypt, after several months of a freeze in FDI announcements, there also seems to be an improvement with more new projects registered. Morocco was different from other Maghreb and Mashreq countries in recording the only significant rise in the number of FDI projects for the first half of 2011 in the region, up 23 per cent in comparison with the first half of 2010. However, FDI flows generally remain lower than those registered before the crisis. This is likely to continue to be the case in 2012.

While Europeans have spent billions of euros funding and designing projects, they have failed to leverage the economic investment to attain a greater political role in the region. Even in terms of trade agreements, the EU has been outdone by the US. When Morocco and Algeria signed free trade agreements with the US, in 2002 and 2004 respectively, they did so on terms that contradicted the commitments they had with the EU. While the EU is still the most important trade and investment partner for its southern neighbours, it is still hard to see greater political leverage. The economic crisis has rendered more pre-eminent the geo-economic dimension of power relations. But southern member states, in particular, may no longer be able to draw on links going back to colonial times to build privileged positions in terms of trade, investment, public procurement and energy supplies.

Inflated expectations?

Europeans may very well fare better in the Gulf where European banks are courting Sovereign Wealth Funds in the hope that they will buy the mountains of assets they have to sell. EU member states are courting Gulf regimes in the pursuit of trade opportunities and investors. The region has increasingly become an arena for competition among, most notably, Germany, France, the UK and Spain. Competition over the supply of tanks to Saudi Arabia is a case in point, with Spain, France and the US vying for a contract potentially worth €3 billion and Germany selling 200 leopard tanks to the country. The large development plans funded by ample reserves from energy revenues are an important field for competition among Europeans. Saudi Arabia alone has plans for $400 billion (approx. €302 billion) in infrastructure expenditure. In 2011 Spain beat French rivals to a €6.7 billion contract to build a high-speed railway between Mecca and Medina in Saudi Arabia. In fact, Gulf Cooperation Council (GCC) countries are projected to spend up to $97 billion (approx. €73 billion) between 2011 and 2020 on new road and railway projects. The Saudis are said to be making an aggressive push to increase trade with the UK. A Saudi Finance Forum held in London in October came on the heels of visits by trade experts from the UAE, Saudi Arabia and Qatar to the northeast of England to try and encourage more local companies to explore business opportunities in the Middle East. The UK and UAE governments have committed to increasing bilateral trade to £12 billion (approx. €14 billion) by 2015, a 60 per cent increase from current levels.

Nevertheless, Europeans have a weak presence in the Gulf compared to other actors. Member state competition together with reluctance to upload bilateral policies to the EU level will not serve their case. The Gulf's gaze has shifted east and many consider this a lost opportunity for Europe. Energy, trade, remittances and investment flow much more intensively between the Gulf and Asia where economies unhindered by the crisis are still growing and will continue to grow in 2012. European firms are routinely outbid by cheaper Korean or Chinese firms. Asian and emerging markets (mainly China, India and Brazil) enjoy big advantages in the region through their growing economic power, their lack of imperialist baggage and the post-financial crisis weakness of the Europeans. While France and the UK hope to achieve some dividend from their leadership of the intervention in Libya, commercial gain might prove tough in the region overall. Since 2000 the region has experienced the increased presence of new economic actors, with China investing more in specific regional niches (textiles, electronics), Russia and India prospecting for new defence markets and opportunities (Russia with Algeria, Syria and Saudi Arabia; India with Israel) and Brazil trying to find new investment opportunities in the MENA region as a whole.

Circumspection required

Europeans played no role in the initial Arab uprisings and the new regimes are unlikely to be keen to replicate European models. In fact, the liberal economic model was discredited by the corruption associated with the overthrown regimes that enjoyed the backing of international financial institutions. In 2011 Egypt initially rejected a $3 billion (approx. €2.3 billion) IMF loan. In the past, the EIB has been criticised for narrowly investing in fossil fuels. Representatives of the transition governments, aside from being disappointed by the paltry sums that they have so far received in aid, have the feeling that external actors are 'jockeying for position and trying to promote their own interests'.

Europeans will need to tread carefully. In 2012, the focus should be on helping countries in transition retain ownership over their future and ensure that reform is facilitated rather than drowned by external support. In the year ahead, new European policies should be designed in response to demands for change rather than attempting to lead reform. This will best be achieved through transparent, consistent and collaborative exchanges. The EU should reconsider its hub-and-spokes Euro-Mediterranean paradigm and work towards broader regional integration. Such integration would strengthen the region's collective bargaining power and could further political stability. Europe should help the transition states integrate into a multilateral space and adopt multilateral rules rather than vying for bilateral commercial advantages. The strategic value of an economically reformed, regionally integrated and internationally plugged-in MENA region cannot be sufficiently emphasised.

8. Missing Latin America's rise

Susanne Gratius

The European Union has a limited geo-political and declining geo-economic presence in Latin America. Latin America is rising and while Europe maintains its position as a development donor, it is becoming an economic dwarf compared to the United States and China. The EU, including Spain, has been mainly absent from the recent geo-economic opportunities that have arisen in Latin America and particularly in Brazil in the past few years. Europe's share of the region's total trade has fallen from 25 per cent in the 1990s to 14 per cent today; foreign direct investment flows have diminished; and since 2010, China has been the main investor in Brazil.

Unlike other regions that present sharp strategic tensions, the EU has traditionally seen Latin America as a close political ally and a major platform for regional integration and democracy. Through development assistance, a strong diplomatic presence, contacts at all levels and Spain's special connection to Ibero-America, the EU has a strong foundation for influence in the region. But this political capital has not been used to establish a European geo-economic strategy in the region. Moreover, the regional integration model has lost its attractiveness, due to the EU's focus on strengthening bilateral relations with Chile, Brazil, Mexico, Colombia and Peru.

The EU has signed free trade agreements with many Latin American countries, but not with its number one economic and strategic partner Brazil, which is part of the EU-Mercosur negotiation format. The European-Latin American summit, initially scheduled for 2012 in Santiago de Chile, was to be the last opportunity finally to conclude the long-outstanding EU-Mercosur FTA. At the time of writing, the summit has just been postponed to 2013. This is another symptom of Europe's economic decline in Latin America.

Bilateralisation and no progress with Mercosur

Compared to China's engagement and the US presence, the EU has lost economic weight in Latin America. Former strong investors such as Germany have begun to divert their interest towards Asia. In Spain, the economic crisis has reduced the Latin American commitments of many Spanish companies. The EU did sign 'free trade plus' (development and dialogue) agreements with several partners – Central America, the Caribbean, Chile, Colombia, Mexico and Peru – to counterbalance trade diversion towards the United States and Asia-Pacific. Nonetheless, all these Latin American countries together account for less than 3 per cent of the EU's external trade and, unlike Mercosur, none of them consider the EU their main economic partner.

In 2012, it is now unlikely that the twelve-year long EU-Mercosur negotiations will finally be concluded. It is true that after the recent formal announcement that the agreement could be finalised by the end of 2011, commercial offers will be presented during 2012. But this does not guarantee progress. In 2004, the two sides reached this same stage in the negotiations, but then failed to achieve any tangible results. At present, the political will for a breakthrough is not apparent. Given the European Parliament's opposition and the 2012 elections in France (the major veto power on agricultural issues), unilateral European concessions to Mercosur are unlikely in 2012. If the Santiago summit is indeed cancelled, the next window of opportunity will be 2014, and then only if the EU agrees in the next two years on a substantial reform of its Common Agriculture Policy.

The EU already missed an opportunity to conclude an agreement in the 1990s, when integration and economic blocs seemed to dominate international relations and Europe's trade and investment flows with Mercosur reached new records. Today, the EU holds a large trade deficit with the bloc. In particular, Spanish and French investments in South America have declined, while Germany's economic interests outside Europe now concentrate on Asia.

Relations with Mercosur are also a barometer for Europe's type of engagement in the region. At the moment, the EU follows the US strategy of signing collective FTAs with small partners (Caribbean and Central American states) and bilateral deals with advanced economies. Although it is still seen as a model for regional integration, the EU now tends to abandon inter-regional cooperation schemes in favour of an increasing bilateralisation of relations with larger countries with which it has already signed FTAs or with its strategic partners Brazil and Mexico.

The EU has had little influence over or involvement in the recent integration processes in South America, which has been carried out under the Brazilian umbrella. So far, the EU has neither established a political dialogue with the Union of South American Nations (Unasur) nor has it been involved in the Community of Latin American and Caribbean States (CELAC) project that was launched in 2010. This has led to a declining European influence in a traditional partner region, which in part thanks to European development assistance and expertise has managed to improve its social and economic indicators and to consolidate democracy.

Declining economic relations

Neither Spain, Latin America's main European investor, nor Germany, once the region's main trading partner, have made serious efforts to slow the EU's geo-economic decline in the region. In general, total European direct investment flows fell by 23 per cent between 2008 and 2009. In recent years, there has been a striking reduction in Spanish investments in Latin America. Spain's recently elected centre-right government led by Mariano Rajoy has committed itself to reversing this declining presence in 2012. There has been a very modest increase in German, British and Dutch FDI flows to the region.

In 2002, Spain accounted for 22 per cent of Latin American FDI stocks; seven years later, its share had shrunk to 13 per cent. Nonetheless, Latin America is still the main market for Spain's largest multinationals. Nearly half of the profits of companies such as the Santander Group, BBVA, Endesa, Iberdrola, Telefónica and Repsol are generated in the region. In a time of recession, Latin America has become an attractive dynamic market for the declining Spanish economy. In November 2011, the director general of Santander Bank warned that Spanish companies have to start a second wave of investments in Latin America if they are to maintain their comparative advantage against other competitors.

Until the end of the 1990s, Germany was Latin America's most important economic partner in Europe. In terms of stocks, Germany is still the third largest investor in Latin America – behind the United States and Spain. But today, the region represents only 5 per cent of German FDI flows and accounts for 1.5 per cent of its trade – a smaller share than trade to Sweden. Germany's cautious economic re-engagement concentrates on Brazil (in 2010, trade increased by 24 per cent), due to the latter's infrastructure needs and high growth rates (7.5 per cent in 2010).

Companies in the Netherlands and the UK have also increased their investments in Latin America. In 2010, British firms led European investment flows in Peru, and the UK became the second largest investor in Chile and third in Argentina. Meanwhile, Dutch investments represented the main source of FDI in Mexico.

Today in Latin America the EU accounts for the same percentage of trade as Asia, while the region represents only 6 per cent of the EU's external trade. China is already the largest export market for Brazil and Chile and in 2015 will replace the EU as the region's second largest trade partner. Trade exchanges between the EU and Latin America went down by 23 per cent in 2009. Parallel to its lower economic profile, the EU is also losing its political attractiveness. Some polls and commentary suggest that Latin American enthusiasm for liberal democracy and regional integration is diminishing. For some populist regimes China represents an alternative model of authoritarian state capitalism.

In general, there should be no trade-off between European economic interests on the one hand, and human rights or democracy, on the other. Neither Cuba nor Venezuela have signed trade deals with the EU. Nonetheless, the presence of Spanish companies in Colombia and Venezuela influences EU policies towards both countries. The human rights concerns of the European Parliament now hinder the ratification of the FTA with Colombia, which has been strongly pushed by Spain. But Hugo Chávez' authoritarianism has not been an obstacle for Spanish business in Venezuela. Since Repsol and British Gas participate in the exploration of large gas fields it is highly unlikely that the new Spanish government or any other European member state will make human rights an issue in Venezuela. Venezuelan elections in 2012 will be dominated by the president's illness; the EU will need to stake out a clearer position as the different parties begin jockeying for a possible post-Chávez scenario.

Latin America's rise

The trend of declining EU trade and investment flows contrasts sharply with Latin America's geo-economic rise. Even if lower commodity prices and FDI flows reduce economic prospects for 2012, with an expected 4 per cent GDP increase Latin America will be a motor of global growth. In 2010, the region accounted for 7.9 per cent of global GDP, nearly twice as that of Russia. Brazil is now the seventh largest economy, just behind the United Kingdom and surpassing Italy and India. Even though this will not be the Latin American but the Asian decade, in most parts of the region things are going reasonably well.

Due to Brazil and other larger economies such as Argentina, Colombia, Chile, Mexico and Peru, Latin America has not disappeared from the global map. Instead, the region is experiencing a comeback to the international stage. It is no longer rare to see Latin Americans holding high-level economic positions: José Graziano da Silva (Brazil) has been elected President of the Food and Agriculture Organisation (FAO) and Ángel Gurría (Mexico) is the head of the Organisation for Economic Cooperation and Development (OECD). Argentina, Brazil and Mexico participate in the G20; Brazil is part of the powerful BRICS group; Chile and Mexico are OECD members and Colombia will soon follow suit.

Latin America's increasing economic weight is based on natural resources (13 per cent of global oil reserves), successful socio-economic reforms, the rise of Brazil, and the appearance of new partners in the Asia -Pacific. These factors have helped to change the traditional image of Latin America as part of the Western values-based alliance towards a new identity closer to Brazil's 'southern approach' and Asia's economic interests.

It is a paradox that Europe has been a key promoter of Latin America's stabilisation process, but is now absent when the benefits of this process are there to be reaped. The region's global re-engagement is also the result of Europe's long-term development assistance and participation in the region's gradual recovery since democratisation. Through macroeconomic transformations and social progress, Brazil, but also Argentina, Chile, Colombia, Mexico and Peru have managed to expand their domestic markets. Latin America has learned from the lessons of the past. Most countries in the region have been only mildly affected by the global economic crisis, particularly in comparison to Europe.

Latin America's recent economic success story is based on new partners and a further disconnect from Europe. Asia-Pacific has become the region's second trade partner. In 2010, it accounted for 27.2 per cent of Latin American imports and 17.2 per cent of exports, not much behind the US. The EU's current market share (12.9 per cent of exports and 13.7 per cent of imports) is even lower than that of weak intra-regional trade exchange within Latin America itself. Since the 1990s, Europe has lost more than 10 percentage points in Latin American trade.

Hopes that the EU-Mercosur negotiations would soon be concluded and that the WTO Doha round would improve access to traditional agriculture markets have vanished. As an alternative, South America began to approach Asia-Pacific. China in particular has sharpened its profile in Latin America. It is a member of the Inter-American Development Bank, accounts for 9 per cent of the region's FDI and has signed FTAs with Costa Rica, Chile and Peru. As a BRICS member, Brazil has become China's closest political ally in Latin America. Under this scenario, a European economic re-engagement in Latin America would also be a way to connect to Asia-Pacific.

Balancing geo-political and geo-economic presence

Once considered as an alternative partner to the United States, the EU no longer plays a major role in South American geo-economics. Brazil is now the main actor, with Chinese influence rising fast. The EU is still the main source of FDI in Latin America (mainly to Brazil, Argentina and Mexico), but decline is evident. In 2006, the region accounted for 15 per cent of European extra-regional FDI outflows; three years later, it had sunk to 6.9 per cent. This can be attributed to the missed opportunity to re-engage Brazil through Mercosur.

Despite the FTA, in 2010 Mexico was only the EU's twentieth trade partner; Brazil ranked tenth. Even for Spain, Brazil is by far the most relevant partner in the region and concentrates most European investment. In 2012, the EU's own geo-economic interests should motivate it to use the comparative advantage of its strategic partnership with Brazil to increase efforts to conclude an FTA with its second most important strategic partner in the Americas (after the US).

FTAs with minor partners, development assistance and political dialogue help to strengthen the EU's presence in the region but are not enough to include the EU in the new Brazil-China dominated South American geo-economic game. The EU has still not used its strong geo-political potential in Latin America – through development assistance, diplomatic presence, political values such as democracy, peace, integration and social cohesion, and long-standing local contacts – to increase its market share. Given Latin America's rise, it is an anachronism that the EU still perceives the region as a commercial threat rather than as an economic opportunity.

This does not imply adding more countries to the rhetorical list of strategic partners, but using the EU's position and positive image as main donor to increase its economic presence, particularly in the fastest growing countries of Argentina, Brazil, Chile, Colombia and Peru. Moreover, the EU should move its multiple strategic partnerships (Spain has six in Latin America) from rhetoric to increased trade and investment.

Apart from economically re-engaging Latin America, the EU should make a stronger case for regional integration. It can do this by expanding its political dialogue to include new entities such as CELAC and Unasur and by concluding the Mercosur agreement. Inter-regionalist formulae have been applied to smaller countries, but not to engage the larger states. The trend towards bilateralism is evident. Chile, Colombia, Mexico and Peru have signed FTAs with the EU, while Brazil and Mexico are strategic partners.

Both the EU and Latin America should look beyond the development paradigm and take advantage of similar experiences, especially in terms of economic crises. Latin America has been an important laboratory for financial crisis management – Mexico in 1994, Brazil in 1998, and Argentina in 2001. At the Brazil-EU summit, held in October 2011 in Brussels, president Dilma Rousseff recommended a heterodox policy based on adjustment policies and human development to solve the euro crisis. The next G20 meeting, to be held in Mexico in June 2012, will offer an excellent opportunity to move forward in this direction.

Unlike in several other regions, in Latin America the EU's geo-economic efforts have not intensified. The main challenge in 2012 will be to strike a balance between politics and economics. Throughout the year ahead, there will be several opportunities to further the EU's geo-economic presence. Amongst them are Mexico's presidential elections and upcoming G20 presidency. The new Spanish government has proclaimed that precisely for geo-economic reasons from 2012 onwards Latin America will be once again a priority for Spain's foreign relations. This may be the first sign that the European neglect of Latin America could begin to be taken seriously in 2012.

9. Reaching out to the Caspian

Natalia Shapovalova

In 2012 the geo-economics of energy will require the EU to build a far stronger foreign policy presence in the Caspian region. The increasing importance given to natural gas will be factored into European governments' energy calculations as their crisis-hit economies search for cheaper and diversified supplies. The highly challenging political context of the Caspian will provide a stern test for the EU's approach to geo-economics.

In September 2011 member states empowered the European Commission to negotiate a legally binding treaty between the EU, Azerbaijan and Turkmenistan to build a Trans-Caspian pipeline system. This is the first time that the EU will act as a single actor in the energy field, arranging supply contracts with third countries. This potentially marks a U-turn from the previous prevalence of 27 different national energy strategies. The need for a new transit route to bring energy from new sources such as the Caspian basin has become the EU's number one infrastructure project beyond its borders in the last ten years.

In 2012 the EU and Kazakhstan, which holds the second largest gas reserves in Central Asia, will aim to make headway on an enhanced energy agreement, the first of its kind offered to a Central Asian state. Trade and energy cooperation are to be the key elements of the accord. Following Russia's expected WTO entry at the end of 2011, Kazakhstan aspires to join the organisation in 2012. This will open the door for more intensive trade relations between the EU and the richest country in the region. The EU is the major destination for Kazakh exports and the largest source of foreign investment. The EU also invited Kazakhstan to participate in the Southern Energy Corridor, but Kazakhstan turned down the invitation arguing that it does not have available gas. All its gas exports go to Russia and Astana does not want to upset Moscow, especially when the Trans-Caspian pipeline project is still uncertain. However, if gas production in Kazakhstan continues to expand, in the future the country might direct part of its exports to Europe.

The Caspian states that are keen on further diversifying their energy exports show interest in the EU's pipeline projects. The EU is regarded as a reliable trader. Unlike Russia or the US, Europe is also seen as a relatively neutral player in the region that does not try to isolate other powers. However, competition for gas resources in the Caspian is growing. Russia has already protested against EU plans to build a pipeline through the Caspian Sea and when Vladimir Putin returns as president in 2012 he will be ready to tighten control over the former post-Soviet territories and their strategic infrastructure. At the same time, Turkey, China and other Southeast Asian countries are also following geo-economic strategies to hunt for Caspian gas to satisfy their growing energy demand.

According to the International Energy Agency, the world may be entering 'a golden age of gas', as consumption is expected to grow inexorably up to 2035. The EU's demand will grow too, increasing dependence on non-European suppliers. Gas production in the EU is in decline. Moreover, while unconventional gas exploration is booming in China, the Americas, Africa and Australia, shale gas reserves in the EU are modest (the largest ones are in Poland and France) and there is already environmentally-based opposition to their exploration in several European countries.

Geo-economics and energy

Control over energy flows is a crucial element in the geo-economic strategies of Russia, China and the US. This was not the case for the EU until very recently. The EU was slow in deepening its internal energy market and in extending this beyond its borders. Energy security was largely outsourced to external powers. Russia was widely viewed as a reliable natural gas supplier, while the Gulf played this role in oil supplies. Individual member states acted geo-economically in pursuit of their own national security of supply goals. Most notably this was the case with Germany and Italy in Russia; Spain, Italy and France in the Middle East; and new member states' reaction against Russian energy pressure.

The EU's emergence as a geo-economic actor in energy affairs during the past decade has been driven by new threats such as the scarcity of resources and increasing dependence on external supplies, and aggravated by the geo-political behaviour of key supplier states as well as growing competition worldwide. The diverging geo-economic strategies of member states have weakened the EU as a block; a common geo-economic strategy is overdue.

The EU now attempts to construct an integrated European energy space that will include its neighbours, but also more distant countries that are important links in the energy supply chain. Energy interests have led the EU to expand its activity beyond its traditional zones of engagement. As such, the EU has increased its presence in the South Caucasus and in 2004 included this transit region in the European Neighbourhood Policy. The EU has also reinforced its presence in

Central Asia through its 2007 strategy for the region. Similarly, the EU has established energy dialogues with Azerbaijan and other energy rich countries in Central Asia by signing memoranda of understanding on energy cooperation.

The EU's main policy tools are trade, investment, aid, technology transfer and the sharing of legislation and governance techniques. Moreover, the EU is increasingly investing in a more classical spatial control based on physical access to third countries' territories (pipelines and other energy infrastructure). The EU's rhetoric and steps to increase its involvement in the resolution of the South Caucasus conflicts can be seen as an attempt to protect current and future energy infrastructure. Supply imperatives will push the EU further in this politicised direction in 2012, with consequences for its broader regional strategy in the former Soviet space.

Obstacles to the EU's strategy

In 2012, the EU must address a number of abiding shortcomings to its policies: the still incomplete internal market; the diverging geo-political strategies of member states; more efficient regional competitors for Caspian energy resources; and security risks emanating from some of the most authoritarian and corrupt governments in the world.

Big European energy companies still do not support the Southern corridor project. Most large EU member states support both the EU Southern Corridor pipelines – the large capacity Nabucco and the small capacity Trans Adriatic Pipeline (TAP) and Interconecttion Turkey -Greeck-Italy Pipeline (ITGI) – and increased energy cooperation with Russia. If built, the Russia-led rival South Stream, together with the Nord Stream due to be completed in 2012, will further deepen EU dependence on Russian supplies.

The economic crisis in Europe threatens the much-needed increase of public and private investment for the planned projects. The future of Nabucco remains uncertain. There are potentially cheaper competitors, such as BP's proposal for the South East Europe pipeline bringing gas from Azerbaijan to Europe. Nabucco's planned capacity implies gas deliveries from larger and 'difficult' suppliers such as Turkmenistan, Iran and Iraq. The Trans-Caspian project is even less certain. 2012 may be a make or break year for these crucial energy projects, which may flounder without firmer European commitment.

Russia is against both Nabucco and the Trans-Caspian project. If completed, these pipelines will undermine Russia's position as the main gas supplier to Europe and the Russian monopoly over Central Asian gas transit. It will also threaten Russia's geo-political influence in its former territories. With Iran's support, Russia has already used the Caspian Sea dispute as an argument against EU plans. However, unlike Moscow, Tehran's stance would change if Iran itself were involved in the project; but that is unlikely to happen in 2012 due to the nuclear programme and international sanctions.

Kazakhstan is a traditional ally of Russia, now through the customs union, and is hesitant to join the Trans-Caspian pipeline. Russia also continues to be the largest importer of Turkmen gas and the only source of support for Ashgabat's isolated authoritarian regime. Ashgabat has plans for a pipeline linking its gas fields with Afghanistan, Pakistan and India. The latter are supported by the US, which hopes they will eventually contribute to the economic development and stabilisation of Afghanistan.

China is a much more effective competitor at present than the EU. It is ready to pay for and build pipelines to transport Central Asian gas. While the EU took years to approve the Nabucco project, China quickly built a Central Asia Gas Pipeline connecting it with Turkmenistan, which will soon have another link with Western Kazakhstan. The expanded Central Asia Gas Pipeline is expected to bring 40 bcm per year by 2012

– more than Nabucco. Furthermore, in November 2011, China and Turkmenistan agreed on a new contract that could potentially increase Chinese purchases of Turkmen natural gas up to 65 bcm.

Turkey's role in gas transit from Asian countries is also crucial. Although Turkey participates in Nabucco and the 2011 Izmir agreements between Azerbaijan and Turkey opened the way for Azeri gas transit via Turkey, Ankara seems increasingly aware of its 'golden share' in transit plans from the Caspian to Europe. Moreover, Turkey's growing energy consumption and diversification plans (it recently decided to cease imports from Russia) are pushing Ankara to increase imports from Azerbaijan and potentially other Central Asian countries.

Even if supply contracts are in force and the pipelines are in place, questions remain about the security and stability of supply. How can the EU ensure security of supply in light of the existing frozen conflicts in the South Caucasus and the dispute over the status of the Caspian Sea? Can energy supplies from the most authoritarian and corrupted states in the world be stable? In the absence of broader foreign policy efforts to address these kinds of problems, it is doubtful that simply building pipelines will suffice for energy security.

Azerbaijan should be an easier case for the EU. The country is already linked to Europe. The Baku-Tbilisi-Ceyhan and the Baku-Tbilisi-Erzurum pipelines, which transport Azeri oil and gas to Europe have increased the mutual interdependence between the EU and Azerbaijan dramatically. European companies are key investors in Azerbaijan. In 2010, half of Azerbaijan's exports went to the EU, making the Union the country's largest trade partner. Politically, the EU has been involved in Azerbaijan since the late 1990s, first through a Partnership and Cooperation Agreement (PCA), and later within the framework of the ENP and the Eastern Partnership. In 2008, the EU opened a delegation in Baku. Since 2006, the EU has worked with Azerbaijan on energy governance reform and the promotion of renewable energy

sources. Azerbaijan is active in several multilateral energy initiatives, such as the EU-funded Innogate programme (transformed into the Baku initiative); the EU's Eastern Partnership platform on energy security; and the Extractive Industries Transparency Initiative.

Turkmenistan, which holds one of the largest gas fields in the world, will be a much more difficult case. It is among the most authoritarian and isolated regimes in the world. The president controls the country's oil and gas revenues and investors in the energy sector are subjected to the regime's changeable will. The EU has hardly any political presence in Ashgabat. A PCA has not been concluded due to the human rights situation (though in 2011 the European Parliament's Foreign Affairs Committee voted in favour of the agreement's ratification). The EU has no delegation in the country. Turkmenistan is reluctant to participate in EU-funded programmes for Central Asia, even though the EU has managed to involve Ashgabat in a technical human rights dialogue. An energy memorandum was signed in 2008, but it is very limited in scope. Yet Turkmen gas is necessary to fill Nabucco. Given that deliveries from Iran, Iraq or other Central Asian countries are doubtful, Ashgabat is in a strong negotiating position with the EU. Expect some fierce debates over the balance between energy and human rights policies in 2012.

Beyond geo-economics

The European Commission has stressed that the external dimension of the EU's energy market 'must be consistent and mutually reinforcing with other external activities of the EU (development, trade, climate and biodiversity, enlargement, CFSP and others)'. The EU's emergence as a geo-economic actor in the energy field raises questions over how far it will be able to preserve its values-based identity.

The EU, European governments and companies have a rather poor record in linking energy needs and democratic values. The Middle

East and North Africa is a good example of this. A similar pattern has already started to emerge in relations with energy-rich Caspian states. While the EU has applied democratic conditionality towards Belarus and Ukraine, it has never done so towards Azerbaijan. Human rights dialogues established with Azerbaijan and Central Asian states have been criticised for their technical character and limited impact. Meanwhile, the EU is reluctant to bring human rights issues to the agenda at the highest levels.

Protests by oil workers in Kazakhstan have gone practically unnoticed in the EU (except for an European Parliament hearing), while human rights civil society seminars organised by the EU are limited to those topics about which Kazakhstan's government feels comfortable (environment or children's and disabled persons' rights).

The European Commission's 2011 'Agenda for Change' underlines the importance of energy and resource efficiency and low carbon development. The EU's focus on price volatility and energy security in developing countries, climate change and access to secure, affordable, clean and sustainable energy should also be a priority in the Caspian. The EU and its member states should also focus on improving health, access to clean water and labour practices in the region. Impact assessments on environmental, social and labour standards and human rights should be a part of the EU's energy contracts.

The EU's geo-economic energy future

The EU still has to become a fully-fledged energy geo-economic actor. The Eurozone crisis has depleted funds for energy projects, while the EU's big energy companies have their own ideas of where to invest, which does not necessarily coincide with the Commission's will. The largest EU gas companies do not see Gazprom as an unreliable supplier, quite the opposite. They have joined the Russian energy giant's new projects such as South Stream, while preferring to stay away from EU plans for Nabucco.

As a result, EU diversification plans for gas suppliers and routes may struggle to come to fruition in 2012. Nabucco's ambitious geo-economics could be nullified by the business interests of European gas companies and the energy needs of their countries of origin. Russia will remain Europe's key gas supplier far beyond 2012, especially taking into account the closure of nuclear capacities in Germany and Europe's declining gas production. Nord Stream increases the number of Russian gas importers in the EU to include some Nordic countries. Russia's takeover of Belarus's transit system and possible control over Ukraine's gas pipeline will further increase the EU's dependence on gas deliveries from and via Russia.

All this considerably raises the stakes of EU talks with Azerbaijan and Turkmenistan in 2012. But the EU cannot become a mere beggar for gas contracts. When engaging with energy-rich countries, the EU must not forget about the rights and livelihoods of citizens, as well as its own commitments to democracy, development and the environment. The EU's power in the world will further evaporate if European governments and business actors are only seen as partnering with corrupt and cruel regimes. The EU must genuinely support energy reform and economic governance aimed at greater transparency and a better distribution of energy income, which will bring greater economic and political competition in these countries in the long term. In Central Asia and the Caspian the EU risks getting caught on the wrong side of change as it did in North Africa. In this sense, the Commission's recent proposal for EU legislation obliging EU-based oil, natural gas and mining companies to disclose all payments they make to governments worldwide is a step in the right direction and should be given top priority in 2012.

10. Africa Rising?

Oladiran Bello and Manuel Manrique

The eastward shift of the world's economic centre and Europe's economic crisis are altering Africa's traditional position in the international order. Recent geo-economic changes, such as the continent's impressive economic growth, averaging 5 per cent during the past decade, are connected to the emergence of new global players. In 2012, China will host the Fifth Forum on China-Africa Cooperation with an approach that contrasts sharply with the opportunities missed in the third EU-Africa summit in 2010. Distrust there over Economic Partnership Agreements (EPAs) negotiations derailed progress on several policy fronts. As Europe becomes increasingly marginal to changes in Africa, these will have far-reaching implications for future inter-continental engagements.

EU-Africa relations have been dominated by a primary focus on development cooperation, obscuring other important dynamics such as trade. Europe's current economic difficulties and Africa's new dynamism open the space for a transformed engagement. Europe must strike a balance between forward-looking development partnerships and attention to key geo-economic areas. In 2012, the EU's priorities should be to prevent dangerous competition among its member states and fine-tune the articulation between its bilateral, regional and continental engagements in Africa.

Trade, development and regional commitments

The EU-AU strategic engagement has recently laboured to absorb the shocks of the Libyan conflict and an uncertain development cooperation outlook amidst the European debt crisis. Meanwhile, EU efforts to overhaul continental, regional and bilateral relations with African partners remain work-in-progress. To match China's and others' alternative forms of development financing, the European Commission unveiled its 'Agenda for Change' in October 2011, with the private sector and 'blending' grants with loans as new funding sources. The latter especially may prove counter-productive if fixated on leveraging European commercial ventures.

Critical points lie ahead, including the spring 2012 European foreign ministers' decision on whether to endorse this new modernisation agenda. Here, the European Council and Parliament need to provide a counter-weight to big EU member states. Otherwise, the latter risk diluting development policies and rejecting greater coordination in the pursuit of short-term zero-sum national interests. The UK and Germany's revision of national development policies already tend towards greater securitisation of commerce. Such logic can only diminish Europe's credibility and standing as Africa's development partner of choice. As Europe contemplates 'beyond aid' agendas, traditional social-development commitments like the Millennium Development Goals present new practical challenges. A key priority for EU policy in 2012 will be to steer discussions towards a global development framework that acknowledges incipient changes and economic opportunities in Africa. In the year ahead, a practical test will come with the Rio+20 Earth summit, where Europe must collaborate with Africa for a strong agreement that overcomes the Copenhagen fiasco.

Meanwhile, rather than greater EU-level coordination, trends point towards an increasingly competitive geo-economic edge to European states' actions. This was seen in 2011 as Angela Merkel, Nicolas Sarkozy and David Cameron all visited African countries. It is clear that the potential fallout of uncertain trade negotiations is leading member states to weave alternative strategies for national economic interests. Germany's new 'Strategy for Africa' emphasises economic, governance and energy partnerships as alternatives to development assistance; and the country has just concluded negotiations with fifteen Southern African Development Community countries, to boost Germany's presence. France's development agency has similarly announced a €100 million credit facility to Sere Wind Project owned by South Africa's Eskom, just two weeks after a disappointing EU-South Africa summit. Also, energetic British commercial diplomacy in Africa has seen the Foreign and Commonwealth Office take over important portfolios from the development ministry, DfID.

But the 'aid-for-trade' agenda is hampered by EU unilateralism as much as by bilateral actions. The deadlocked EPA talks are entering a parlous final phase, with the Commission's ultimatum to 18 rejectionist countries to accept EPA offers or lose market access to the EU from January 2014. This has been criticised as an attempt by a desperate EU to 'divide-and-rule'. Stalled EPA negotiations and growing bilateralism present severe risks of fragmented EU action, precisely when Africa is taking issues into its own hands. New negotiations are underway for the establishment of a large free trade area covering 26 eastern and southern African countries. In 2012, the EU must follow such developments closely while reaching mutually satisfactory EPA outcomes and better coordinated EU external action across trade and development.

Key geo-economic arenas

The geo-economic scenario taking shape carries both opportunities and risks for EU-Africa relations. Meanwhile, policies like the Joint Africa-EU Strategy have failed to frame a common European approach, opening the door to fragmented and competitive actions from EU member states. Spurred by emerging global actors, a de facto geo-economic European perspective is increasingly visible in at least three crucial areas: energy, infrastructures and market opportunities.

Natural and energy resources constitute Africa's largest exports, and have driven GDP growth over the last decade. Whilst China's 'no-strings-attached' approach to Africa's extractive sectors in Angola and Sudan has been criticised, Europe maintains similar strategic interests elsewhere in Africa. New oil and gas discoveries in Ghana, Tanzania, Mozambique and Namibia will open up competition for new production contracts. Lucrative but opaque like most African extractive sectors, corruption in Uganda's oil sector has seen some setbacks in EU governance reform efforts. Anglo-Irish firm Tullow Oil is embroiled in a legal controversy with lawmakers, and Canadian, Chinese and Italian rivals. The renewable sector, where Africa can also play a critical role in European energy security, offers sustainable long-term potential. The unveiling of the €400 billion German-led Desertec Initiative, constitutes the most important move, as it aims to provide 15 per cent of Europe's energy supplies by 2050.

The EU must ensure that this and similar initiatives are compatible with longer-term development objectives. Infrastructure building also offers opportunities, with emerging countries in pole position: South Korea, for example, is building 30,000 houses in Ghana for $1.4 billion (approx. €1.05 billion). Credit lines backed by oil and natural resources have boosted the infrastructure sector, but have also raised important questions. The China International Fund , notorious for its dealings in Angola, Zimbabwe and Guinea, recently failed to secure the construction of Dar es Salaam Airport's Terminal 3. Tanzania's preference for Dutch company Interbeton BV shows there may be an advantage for European companies to forego excessively aggressive bidding and non-transparent contracting.

Emerging African markets can also transform the continent's integration into the global economy. Although Europe holds an advantage, with 41 per cent of Africa's total imports, it is being aggressively challenged. The EU's internal market weakness will likely see Africa gain prominence. Spain's food exports to Africa grew 43 per cent in the first half of 2011 and already reach 52 African countries. Commercial diplomacy will be a priority for the new Spanish administration in 2012 and although Latin America is prominent, interests in sub-Saharan Africa can also be boosted. Unilever (UK-Netherlands) and London-based SABMiller have ambitious expansion plans for African markets averaging double-digit growth. Competition is, however, increasing from outside the EU. US supermarket giant, Walmart, recently took a 51 per cent controlling share in South Africa's Massmart at a cost of €1.5 billion.

In the long term, Europe's prospects depend on its consolidation in key African sectors like telecommunications. Here, European (France's Orange, Luxembourg's Milicom and UK's Vodacom) and South African (MTN) operators have dominant market shares but face hostile competition from India's Bharti Airtel. In the handset market, Finland's Nokia is being challenged by China's ZTC Communications and Taiwan's HTC, thanks to the latter's popular low market-end smart-phones. Events like the fourth German European Business Trade Fair held in Ghana in October 2011 have aimed to defend Europe's economic interests in Africa.

Beyond its consumers, Africa can secure sustained economic growth and structural transformation thanks to the abundance of cheap labour. Manufacturing activities would add value to Africa's exports, and bring technology transfers that benefit the 'bottom of the pyramid'. FDI to

Africa is expected to reach $150 billion (approx. €1.12 billion) by 2015, which could create 350,000 jobs a year. The 'bad news' for Europe is that emerging markets like Brazil currently offer more attractive partnerships in African sectors like agriculture. Link-ups with emerging partners offer shared benefits: a new cashew-nut processing factory at Techiman (Ghana) will create local jobs, but also give its owner, India's Rajkumar Impex, a base to serve African, European and US markets. Europe has nonetheless recognised this potential: since 2010, two South African companies manufacture Airbus components.

Although there are country and sectoral differences, the overall message is clear: geo-economic engagement constitutes a much-needed complement to traditional development cooperation but EU actors will lose out unless they pull together to exploit comparative strengths and advantages. As a cohesive entity the EU still possesses aspects of appeal. Africans covet the socially responsive model that, for some, is the hallmark of the European integration experience. The African Development Bank has also highlighted risks associated with income inequality; and unions' opposition to Walmart's labour policies in South Africa makes it clear that Africa is open for business but not at any price. As Africa's main trading partner, the EU should not adopt unhelpful zero-sum calculations. A mutually supportive European economic agenda backed by credible development policy is of utmost importance to help shore up Africa's transformative prospects while preventing dangerous intra-European competitions. Short-sighted adventures like the UK's first ever parliamentary delegation to Equatorial Guinea in October 2011 risk unleashing a dangerous European race to the bottom.

Shifting regional scene

Within Africa itself, emerging geo-economic orientations among big continental players offer a flavour of the less certain future in which the EU must navigate. South Africa is the continent's biggest economy and largest beneficiary of EU bilateral aid through the Trade and Development Cooperation Agreement (€980 million in 2007-2013). Yet, the country pursues a multi-vector foreign policy, evident in its admission as fifth member of the BRICS club in 2011. Despite repeated denials, South Africa is now drifting away from the EU's orbit. Time and again, it has taken positions radically different from the EU. Recent falling-outs over Libya and Ivory Coast replayed earlier tensions over Zimbabwe and at the Copenhagen summit. This raises crucial questions about geo-political shifts within Africa and the EU's longer-term geo-economic positioning with key players. In 2012, it will be vital to identify more clearly pivotal actors that connect interests and concerns within sub-regions, correcting the national and continental character of the two existing, and underperforming, EU strategic partnerships in Africa (with South Africa and the African Union). Both have so far been sustained more by declaration than utility.

In an age of heightened geo-economics, geostrategic positioning also requires radical review. Nigeria highlights emerging gaps between intra-African trends and the EU's current orientation. The country is a strategic energy supplier (80 per cent of its gas production is exported to the EU), and its economy is expected to surpass South Africa's by 2023. Despite its pre-eminence, Nigeria remains on the fringes of the EU strategic imaginaire, including on trade, security and development in the Sahel region and West Africa. A second EU bilateral strategic partnership with Nigeria would guarantee better coverage of the EU's diverse portfolio of interests on the continent, while solidifying a longer-term economic and development partnership with Africa's future economic and demographic heavyweight; Nigeria is home to nearly a quarter of Africa's population. The need for EU repositioning is itself revealed by the expanding diplomatic rivalry between Nigeria and South Africa, including over a permanent UN Security Council seat and elections to the African Union Commission chair in early 2012. South Africa is breaking with convention to present former minister Nkosazana Dlamini-Zuma against the incumbent, Jean Ping. A two-pronged bilateral strategic engagement with the continent's leading powers could help the EU shape African politics and economics. 2012 must therefore see a renewed effort towards a Nigeria-EU strategic partnership.

Challenges in 2012

Europe's economic problems and Africa's economic re-emergence may together transform future EU-Africa relations. As new players seek key roles in Africa, Europe maintains a head-start in critical sectors, thus making debates over development, trade and strategic architectures crucial. If adopted in 2012, Commission proposals to modernise European development policy can open up new vistas for more efficient and adequately resourced cooperation and development finance, with more room for the private sector. Challenges remain for the EU in managing its search for economic revival alongside resurgent geo-economic national perspectives. Effective recalibration of external action instruments requires first and foremost reconciling values and interests at the EU and member state levels. The often-mentioned Policy Coherence for Development stipulates a more forthright acknowledgement of reciprocal responsibilities between development efforts and economic priorities of individual member states. Phrases like 'mutual interests' and 'global commons' are used to describe the EU's emerging orientation, but striking the right balance between interest and global responsibilities requires greater clarification of how Africa's prosperity is inter-twined with Europe's economic recovery.

Europe must recognise the potential of Africa's energy, infrastructure sectors and new markets without forgetting the need to embed future progress within collective EU approaches tailored to mutual solidarity. Increasingly disparate commercially-oriented policy from member states can lead to EU fragmentation and even undermine common trade and development policies towards Africa in 2012. Long-term interests, however, require collective action that is still possible, starting with functional strategic partnerships with key states. Failing this, the existing window of opportunity will dissolve in short-sighted geo-economic calculations, to the detriment of both Africa and Europe.

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