

Issues for Europe – Post-11 September

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ISSUES FOR EUROPE – POST-11 SEPTEMBER

MICHAEL EMERSON AND DANIEL GROS*

CEPS Policy Brief No. 8/September 2001

Ten days now after 11 September, the policy agenda becomes a huge set of interlocking issues – political, strategic, economic. The present note makes a first survey of these issues, and expresses opinions on some of them. However the main purpose is to establish a template or framework to help monitor and evaluate the evolution of the world's response to this massive event. It will be updated and revised in further *CEPS Policy Briefs* as the story unfolds.

Summary assessment to date

- (A) *Politics and security.* Alliance building and careful calibration of the nature of the riposte seems to be proceeding well. Early concerns that Pentagon hawks wanted to attack many states more or less connected with Bin Laden activities in the past seems to have given way to the choice of a tightly targeted military riposte hitting Afghanistan, alongside as extensive as possible alliance building elsewhere in the Arab/Islamic world, as well as of course Europe including Russia. Such a strategy is definitely that desired by Europe.
- (B) *Economics.* There is at least a technical recession to confront in the US and at least an interruption of growth in the EU. However policy makers in both the US and EU, both monetary and fiscal, are reacting promptly with countercyclical policy. This should work, notably since there is little reason to expect that 11 September has altered the medium run outlook for the world economy.

1. This was indeed a defining moment, the first post-modern war¹

It was more than just a terrorist act, but not an inter-state war, yet one in which the world's only superpower revealed a colossal vulnerability. The spectre of nuclear or biological warfare terrorism becomes more vividly plausible. But, as Solana stressed before the European Parliament on 19 September, this is neither a crusade nor a war against Islam nor against the Arab world.

2. What kind of riposte?

The US prepares to take the major initiative, especially militarily. The EU joins in as ally over a wide range of options, and is progressively defining its position in a fast-moving situation. The menu for the riposte may look like this:

a) counter-attacks of varying intensity and breadth

- ultimatum to host state for extradition of the prime suspect and dismantlement of terrorist facilities (which is what President Bush demanded in his speech to Congress on 20 September);
- cruise missile attacks on terrorist targets; and/or by special commando forces;
- wider terms of reference for counter-intelligence, including authorisation of political assassination (“wanted dead or alive”);
- support for surrogate opposition forces in selected places;
- punitive attacks on ‘non-cooperative’ states;²

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¹ See, for example, François Heisbourg, “De l’après-guerre froide à l’hyperterrorisme”, *Le Monde*, 13 September 2001.

b) protective measures

- increased police and intelligence cooperation;
- tightening of travel and domestic security arrangements/standards;
- tightening up on international financial assets of suspect parties;

c) diplomatic-strategic

- new international alliance to combat terrorism, including Russia as well as NATO, with a multi-faceted long-term action;
- renewed efforts to secure peace between Israel and Palestine;
- recourse to UN, renewed interest (on US side?) in global multilateralism.

Put in more general policy terms, there is the choice of strategy between two types: on the one hand *unidirectional policies* of counterattack of varying intensity and breadth, and, on the other hand, deliberate *policy mixes*, which also bring in measures to remove or lessen fundamental sources of conflict (viz. peace process and political negotiations in Middle East), so to avoid above all a Huntington-type confrontation between the West and the Arab/Islamic world. The EU and especially its NATO members, as the main allies of the US, participate now in a policy dialogue to try to identify the most effective reaction, hopefully with a shared discipline to avoid an excessively hasty riposte which might not well calculate the risks of counter-productive results.

As regards the present state of thinking in the inner sanctum of US policy makers, there is only limited information issued to the public. Of course the military are put onto a state of readiness to execute a wide range of options. Visible displays of military preparations (aircraft carrier movements, pre-positioning of fuelling capabilities for the air force etc.) are serving also as muscle-flexing messages to US public opinion³ and to wavering states. Washington must be examining a wide menu of options. It may be having an argument over the recommended riposte (viz. public exchanges between Powell and Rumsfeld/Wolfowitz)⁴. President Bush's ultimatum speech of 20 September seems to point to a concentrated attack on Afghanistan as the most likely next step. European assessments favour preparation of a maximum international coalition and indeed alliance to combat international terrorism, and minimisation of the risks of increasing polarisation between the West and Arab/Islamic world. This view would restrain military intervention to the most demonstrable terrorist targets, and maximise the build-up of international civilian 'policing action' (to use this term in a wide sense, covering intelligence services, judicial and regulatory systems, special counter-terrorist units etc.).

3. Role of NATO

Paradoxically this first possible recourse to NATO's Article 5 collective defence provision (an attack on one ally is an attack on all) is for a conflict of a type completely different to that originally intended. The debate on how far Article 5 is open for anti-terrorist actions has been ongoing in

² Language of US Defense Secretary Rumsfeld: "Terrorist networks have no armies or high value targets. Those countries that support them do have such targets. They do have armies, navies and air forces and they do have capitals and they do have high value targets. And we are going to need them to stop tolerating terrorists" (*Financial Times*, 18/9/01). See also opinion poll results annexed.

³ See annexed opinion poll results which show the strongly unified state of US public opinion in favour of "military action against states harboring those responsible for the attacks, even if it means many thousands of innocent civilians may be killed".

⁴ Whereas Deputy Defense secretary Wolfowitz has used the bizarre and alarming language about "*ending states*", Secretary of State Powell commented "We're after ending terrorism. And if there are states and regimes, nations, that support terrorism, we hope to persuade them that it is in their interest to stop doing that. But I think that 'ending terrorism' is where I would like to leave it, and let Mr Wolfowitz speak for himself", (*Financial Times*, 20 September 2001).

NATO for some time. For example the 1999 Washington Summit saw Europeans decline a US request to be explicit on this point, and the language adopted in its new Strategic Concept document was indirect: "Alliance security can be affected by other risks of a wider nature, including acts of terrorism". While NATO seems to have agreed in the immediate aftermath of 11 September on the acceptability in principle of a US request to invoke Article 5, if the attack is found to have come from abroad, the debate about what this means for the non-military roles of NATO seems only to have begun.

4. New situation for defence doctrines and spending priorities

For the US, just as the missile defence debate has got under way, and with the advancing military revolution for high-tech zero-casualty war and minimal deployment of conventional forces, the outlook now looks very different. Limited missile defence (against modest rogue state rockets) looks now all the more relevant, but huge investments in strategic missile defence looks all the more questionable, alongside the new priority needs. The implications for European military doctrines and priorities will be different, because of lesser investment in these US-type programmes, but nonetheless extensive.

5. New alliances

The old NATO alliance is being mobilised and validated in a new context. However there openings for a new US-Russian rapprochement, given Russia's engagement in Central Asia with its Tashkent Treaty allies to defend against Afghanistan-based terrorism. Also we hear that Moscow has already begun to change its view of ESDP, giving up the hope of it becoming a wedge between the US and EU, understanding that the EU won't play this game, and that a trilateral cooperation US-EU-Russia is the only relevant scenario.⁵ With an US-Russia rapprochement over international terrorism, the US-EU-Russia triangular cooperation could receive a real boost, with a more positive context within which to handle the NATO enlargement process in a more harmonious way. In addition there is the possibility to bring China into something of a new security alliance, mitigating US-Chinese tensions over other security issues (especially of course if strategic missile defence priorities were lowered). A global summit to concert on counter-terrorism policy is already being advocated, maybe not yet a first G-9 (G-8 plus China), but the idea gets aired.

However in Russia political debate turns in favour of specific terms for a new cooperation with the US over combatting terrorism. Russian *Realpolitik* inclinations are manifest. Various political personalities and commentators are making the following points:⁶ a/ Russia should now solve the Chechen question, dropping negotiation and using force alone, and without international criticism; b/ Russia should take the occasion to re-establish firmer control over Central Asia and the Caucasus more generally. In this situation the position of Uzbekistan becomes particularly important. It is the most populous state of the region, and vulnerable to a militant Islamic challenge to its autocratic and repressive regime.⁷ It declares that it is "open for discussion" about the possible use of its air space or military bases by the US, whereas Russia has declared its opposition to such an eventuality.⁸ This is a further pointer to the likelihood of difficult trade-offs ahead between security and human rights agendas.

⁵ See Dmitry Danilov, "The EU's Rapid Reaction Capabilities – A Russian Perspective", ESF Working Paper No.4 of the CEPS-IISS European Security Forum, September 2001 (see www.eusec.org).

⁶ See Igor Torbakov, "Russia considers its own interests as Moscow ponders anti-terrorist actions", www.eurasianet.org, 18 September. On Chechnya, former Deputy Prime Minister Nemtsov, who has been so far a leading advocate of a negotiated political solution, declared on 13 September: "The very term 'negotiations' should be dropped for the time being. All talks should be conducted in the language of Kalshnikov sub-machine guns only. We should concentrate on the destruction of gangs. That is all. Either we kill the terrorists now, or they will get at the Kremlin one day".

⁷ See International Crisis Group, "Uzbekistan at Ten: Repression and Instability", 21 August 2001.

⁸ *Financial Times*, 20 September.

6. Israel-Palestine

Here there are huge risks and opportunities. The risk is that the Sharon government and US pro-Israel factions will see a moral case and political opportunity to hit Palestinian targets even harder and indiscriminately. This would lead straight into the most alarming escalation scenario for Arab/Islamic-Western relations. The opportunity, if the Palestinians are shown to be basically clean on the 11 September attack, is for the peace process to be relaunched, given also how close to agreement the parties actually got at Taba in December. The most recent developments are positive, to the extent that Arafat has ordered a cease-fire, and on 18 September Israel has ordered also a stand-off by its forces. The possibility of a Peres-Arafat meeting is under intense discussion. However the politics of both Palestine and the Israel coalition government remain extremely tense and precarious. The EU and US, reportedly, have been pushing both parties to take the new situation as an opportunity for de-escalating recent hostilities, and eventually renewing the peace process.

7. Turkey

The need to get EU-Turkish relations on a sound track is even more acute in the new situation, as a front-line state in relation to areas of Islamic militancy. Here also the outlook is for the moment bad, with grave instability in Turkey both economically and politically, the NATO/ESDP impasse unsolved, and the Cyprus question coming fast up on the horizon as a factor of crisis with the EU in 2002. It is therefore so important that there be a closing of the ranks in Turkey-EU-US-NATO relations. But analogous to the Israel case, Turkey should not be encouraged to think that it should now 'deal with' its Kurdish problems without regard to legitimate grievances and human rights criteria.

The economic plight of Turkey, in this new political situation, now makes the case for a package deal of strategic dimensions compelling. The Turkish economy will not survive long with interest rates at close to 100 % while inflation remains at 30-40%. One of the two has to give. Malpractice and corruption in the banking system is also staggering, but under the present combination of sky-high real interest rates and a recession even honest credits start to look doubtful as more and more enterprises go bankrupt. Most of these problems could be eliminated through an economic package consisting of : a) replacement of the Turkish lira by the euro, b) privatisation of the banking system and c) adoption of the Maastricht rules for fiscal policy. Of course a radical measure such as euro-isation would have politically to be a sovereign unilateral choice by Turkey (finance minister Dervis has shown interest in the idea, not surprisingly since the standard IMF support measures have not worked). The whole package hypothesised – euro-isation, bank reform and Maastricht budget rules - would transform the political equilibrium inside the country strengthening the 'Western' element, which seeks to anchor the country to the EU. The dispute over NATO assets and ESDP would be quickly resolved, and in a new climate of fundamental solidarity between the EU and Turkey the Cyprus question could be taken up again with a common resolve to find a solution for the whole of Cyprus soon to enter the EU as full member state.

8. EU 'Borderland Europe' policies

There will surely be pressures to tighten up on Schengen and EU policies on the movement of persons. But this leads into the larger question of EU's 'Borderland Europe' policies, i.e. those policies that relate the enlarging EU to its neighbours. There are two possible tendencies: A) *Fortress Europe*, or 'keep them out'; and B) *Inclusive Europe*, which seeks cooperative and stabilising systems for the EU relations with the non-accession candidate states (stability pacts, cooperative regional dimensions, virtual membership arrangements, protectorate regimes). Many political voices may cry out for more of a Fortress Europe, with the counter-terrorism argument reinforcing the already strong asylum and immigration-defences arguments. However the counter-

argument is that only 'inclusive' policies by the EU towards its neighbours can supply fundamental security over its borders. Moreover, the 'post-modern' enemy knows no frontiers (as the recent example of IRA terrorists helping the Colombian drug barons shows).

9. EU Rapid Reaction Capability

This is already taking shape at the planning stage, with open questions regarding the precise scenarios that it should be equipped to address. The counter-terrorism capabilities will surely be promoted in the priority listings, with more urgency and resources devoted to relevant intelligence facilities and specialised counter-terrorist units. In general a renewed political boost for this slowly emerging EU military capability is called for.

10. EU Justice and Home Affairs

Development of civilian capabilities should be given high priority, with the possibility now to build on recent developments such as the Schengen Information System and Europol. There are further projects currently being prepared such as the civilian Rapid Reaction Capability for deploying police forces into lawless parts of the European neighbourhood, new proposals for a European Public Prosecutor, the 'Eurojust' idea for judicial cooperation and mutual recognition in matters of criminal law, and a European Border Guard.

The Commission published proposals on 19 September for a common definition of terrorism, which is a starting point and prerequisite for developing more comprehensive legal base and policies for combatting terrorism in the Europe. It is also proposed to establish a 'European arrest warrant', relying on the mutual recognition principle and replacing cumbersome extradition procedures. EU finance ministers are working on the implementation of a money-laundering directive.

11. US macroeconomics

The attack came at a time when the US economy was already on a tightrope. Before 11 September there was still no end in sight to the collapse of investment. The key question was whether consumers would continue to underpin demand. It now seems clear that there will at least by a technical recession. Due to the disruption of trade and commerce GDP is likely to have contracted in the third quarter. But this could be the prelude to a V-shaped recovery, if confidence can be reasonably restored, with powerful stimuli from fiscal and monetary policy able to work properly. The key to a recovery would thus be maintaining the confidence (and therefore spending power) of the US consumer, who is responsible for about 70% of overall demand. The first signs are encouraging in that the latest survey, with some input after the attack, actually shows a small improvement in consumer sentiment. US financial markets, which panicked after the Russia/LTC crisis in 1998, seems to have been little affected. The mark-down of asset prices has been limited, there is no shortage of liquidity and there are no signs of market dysfunctions as in 1998 (the spread between on-the-run and off-the-run US Treasury bills has not widened).

The US monetary policy response has been swift and convincing, supported also by 'virtual' co-ordination internationally. There can be little doubt that the FED will undertake further steps if deemed necessary. Fiscal policy will also become quickly expansionary in the US due to reconstruction aid and increased military spending. Both monetary and fiscal policy will become more expansionary than would normally have been justified by the state of the economy, because US policy makers no doubt feel that 'we cannot give the terrorists the satisfaction to have pushed us into recession'.

12. European macroeconomics

Since in Europe the investment boom was weaker than in the US, the bust is also likely to be more limited. Growth may be somewhat below the meagre EU potential, but there is no reason to expect a full-blown recession. Monetary policy is likely to remain cautiously expansionary, now that

inflation is declining and the automatic stabilisers will be invoked to allow a modest expansion of fiscal deficits. Confidence in the ECB has increased considerably after it showed on 17 September that it also, like the FED, can act quickly when needed and cut interest rates decisively. Prior to the attack the main issue had been whether it would be appropriate to let the automatic stabilisers work in the current slow-down and thus allow deficits to widen temporarily. There was considerable opposition to this because the large member countries still do not have the equilibrium on a cyclically adjusted basis that would be called for under the Stability Pact. However the European Council (late on 21 September) has overridden such concerns of some finance ministers and the Commission (witnessed at their meeting a few hours earlier) for the time being, with deficits to be allowed to increase somewhat, thus making fiscal policy also mildly expansionary.

The international spillover effects should also be limited. The value of the dollar could go either way. An expansionary fiscal policy in the US is likely to strengthen the dollar, but an aggressive easing of monetary policy might have the opposite effect. As one does not know yet whether the FED will have to lower rates even more to calm markets it is difficult to know what the net effect is going to be. But whichever way it goes, it cannot be very large as the attack will not affect the longer term outlook for the US economy. However, any outlook for the dollar must come with the health warning that it cannot stay strong forever, for the simple reason that the US current account deficit cannot go on forever at 4% of GDP. But this has been known for some time. Could this event pierce the dollar bubble? This is unlikely to happen in the immediate future. Over the next weeks the FED and the ECB will certainly act to contain any turbulence in the foreign exchange markets.

All in all there is at least a technical recession confront in the US and at least an interruption of growth in the EU. However policy makers in both the US and EU, both monetary and fiscal, are reacting promptly with countercyclical policy. This should work, notably since there is little reason to expect that 11 September has altered the medium run outlook for the world economy. Emerging markets will have to pay a higher risk premium. But given the need to maintain a global alliance against terrorists the US will be much more willing to prevent key countries from falling into a black hole.

13. Oil

This relatively benign economic outlook demands a stable oil price. This in turn depends on the US political-military response and whether it will antagonise the Gulf states. So far the markets have taken the position that this is unlikely to happen. The spot and future prices for oil have barely moved. However this interlocking set of conditions is essential, which returns to the crucial question of the political-military riposte already discussed.

14. European Council

An emergency meeting met in the evening of 21 September to give political orientations for EU strategy. Beyond declarations of political solidarity for the US, three points are notable about the communique:

- i) A US military riposte is judged legitimate on the basis of UN Security Council Resolution 1368, and member states are prepared to support such actions "each according to its means".
- ii) There is large support for the work of Justice and Home Affairs ministers to execute the proposals summarised above.
- iii) On countercyclical policy, it is said unequivocally that budgetary automatic stabilisers should be allowed to come into play.

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