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Exporting Stability to the Wider Europe: From a Flawed Union to Failing States

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The European Union (EU) has to digest its big-bang enlargement, a period of slow growth after the introduction of the Euro, and a cumbersome process of getting a Constitution that still faces some crucial obstacles such as referenda in several rather eurosceptic member states. On top of all that, the enlarged Union has to redefine its relations with the world after the end of the Cold War and after September 11. In this regard, it has agreed upon its first official security strategy (EU 2003a; Flechtner/Lerch 2004). The EU intends to be a source of stability in a world full of partially new threats (terrorism, failing states, diseases, crime, drugs). In particular, it wants to export stability to its neighbourhood, the "Wider Europe" (EU 2003b).

This paper analyses first the supply-side of the stability export: What are the resources and interests of the enlarged EU? Regarding the demand-side, we look at the political economy of the neighbouring countries and try to identify the causes of their instability and the origins of the threats that emanate from these often failing states. In the last section, we evaluate the instruments and policies at the EU's disposal in the light of the problems they have to solve. To sum our central finding up: The present policies of the EU are hardly appropriate to accomplish the chosen mission of stability export. In many cases, strong interests on the EU's side prevent the use of helpful policies and, in some cases, even lead to harmful ones.

A look at the supply side: The flawed Union

If an entity wants to export stability it better has a supply to draw from. But how stable and, perhaps more to the point, how powerful is the European Union after enlargement? Even before enlargement, some general indicators of power looked impressive. The EU had 383 million inhabitants, many of them rich in international comparison. With an average income per capita of 25.000 €, the EU's total gross domestic product (gdp) was 9,5 billion € in 2001, almost as much as the U.S. economy. How do these vast resources translate into power that can be projected abroad? Its member states spend on average 1,9% on defence and 0,3% on aid. Compared to the U.S.A. which spends 3,1% on defence and 0,1% on aid, Europe is militarily weak but relatively generous (albeit far from the 0.7% target it has agreed to). More impressive is the economic role of Europe in the world, and in particular in the Wider Europe. Europe is the world's biggest exporter and investor and a major host region to foreigners (migrant workers, refugees). The size of its foreign economic relations is probably the biggest power asset the EU has, in particular vis-à-vis its neighbourhood whose economies strongly depend on European markets, investment and remittances from migrants working in the EU.

Enlargement does change that picture less than one would expect from the number of new countries joining the EU which represent an increase of 66% (from 15 to 25). The new EU-25 grows in terms of population only by about 20%, and in terms of economic output (gdp) by approximately 5% because of the low per-capita income of the new member states. That small increase adds even less to the size of the EU's foreign economic relations as the new member states do most of their trade with the old EU, and invest little abroad. Their defence spending as a share of gdp corresponds more or less with the EU average. The EU's total expenditure on defence thus increases by 5%, adding less than 15% of Germany's defence budget. The poor new members are even thriftier donors of development assistance, spending on average 0.03% of gdp, i.e. less than a tenth of the old EU's average share of 0,33%. In the end, enlargement adds a lot more voice than muscle to the EU's power profile.

The enlarged EU-25 still lacks a coherent foreign and security policy. Although the new members subscribe to the basic outline of the Common Foreign and Security Policy (CFSP) of the EU as a part of the *acquis communautaire* and, as opinion polls show, their populations share most of the views and priorities regarding foreign policy with the people of the old member states, their governments have occasionally adopted different policies (Dauderstädt 2004b). The regional focus of their aid effort is Eastern and South Eastern Europe rather than the traditional "Third World". During the Iraq crisis of 2002/2003, the governments of the then accession countries shared the U.S. position contrary to some old member states (France, Germany). It remains to be seen how much consensus the enlarged EU can muster when it has to deal with a new crisis in its neighbourhood.

Generally, the capacity of the EU to shape a consensus and take decisions will diminish with enlargement. There will be a growing tendency to preserve the status quo and increasing difficulties to decide in favour of reforms or new policies as the diversity of interests and priorities increase (Dobbins/Drüner/Schneider 2004). In particular regarding the CFSP, the willingness of member states to support a strong supranational role of the EU seems to depend on the strength of the European component of national identity and the structure of domestic regional governance (Koenig-Archibugi 2004). While the identity of the new members is not substantially less European than those of the old ones, their domestic governance usually is highly centralized. Thus we might expect only weak support for a more supranational foreign policy of the EU from their part.

These difficulties of reaching a consensus will be compounded by a growing number of economic and social conflicts regarding the distribution of income and wealth within the EU-25 (Boix 2004; Dauderstädt 2004a). The deepening integration thanks to the Single Market and the Monetary Union has led to competitive pressures in particular on the continental welfare states that make up the old core of the EU. These welfare states had anyway to cope with massive demographic changes, de-industrialization and the unintended side-effects of their own benefits (moral hazard, free-riding, the tragedy of the commons offered by the welfare state such as free health and education). Contrary to the goals and expectations of the Lisbon strategy, the EU is far from becoming "the most competitive knowledge-based economy" (Sapir 2004). Growth has been sluggish, unemployment remains high, and public finances shaky. Liberalization ("negative integration") has fostered productivity growth which has not been translated into output growth because of the stability bias of the ECB's monetary policy and the Stability and Growth Pact. The shadow economy is growing rapidly buttressing the problems of those excluded from the formal economy but, at the same time, undermining the tax base and the social security system.

The major positive effect of the Monetary Union has been the more rapid growth of the periphery (Greece, Spain, Portugal, and Ireland) thanks to the decline of interest rates which has boosted consumption and investment. While the official regional and cohesion policy of the EU has not reduced the income disparities between the richest and the poorest regions of the EU (Funck/Pizzati 2003; Tarschys 2003), EMU has at least reduced those between the rich and poor member states. And EMU with its uniform nominal interest rate set by the ECB continues to do so as the faster growing periphery countries have higher inflation rates and thus lower real interest rates which spur growth and inflation further while the slow growing centre faces high real interest rates which dampen growth and prices (Bofinger 2003). The star performer has been Ireland which is now the second richest member state of the EU – measured by gdp/capita.

That kind of poor countries' predatory growth based on cheap labour, low tax rates, and public goods financed by EU funds will face increasing opposition from the richer countries which financed those EU policies in the first place and loose jobs and tax revenue to these competitors. Inequality rises and unemployment might be reduced only by lowering wages as employment in the public sector becomes too expensive. In the end, domestic demand remains sluggish while people save even more to replace declining social protection. Foreign competition and European integration will be blamed and give rise to political apathy or populist movements. Europe might no longer remain a model of social justice and peace. The economic weakness not only undermines the hard power (defence spending) but also its soft power in terms of market opportunities, foreign direct investment, and aid. Europe still attracts people and states from the Wider Europe that want to live here or become member states of the EU. But this attraction is and has always been based to a large extent on an unrealistic image of Europe as a place where the poor (people as well as countries) can get rich easily.

A look at the demand side: a neighbourhood of failing states

If you exclude Switzerland, Norway and Iceland, the enlarged EU is surrounded by states that are to some degree failing. They fail to fulfil to a satisfactory degree one ore more of the three core state functions: welfare, security, and representation (Milliken 2002). Even the new member states are still poor young democracies. Beyond the borders of the enlarged EU poverty, as a rule, increases with the distance from Brussels (see table 1). The next candidates, Bulgaria and Romania could not join the EU in 2004, because they were late reformers whose transition process started slowly. The western Balkan has still to overcome the consequences of war and ethnic strife. In the former Soviet Union, segments of the old communist nomenclatura succeeded in re-labelling and redesigning their rule. Behind the façade of democracy and market economy political and economic power remains highly concentrated. On the South rim of the Mediterranean, Israel is the only rich democracy, but even the Jewish state is flawed by ethnic-religious conflicts and in a permanent state of war because of its policy of occupation and annexation. The Arab world is poor, except where oil revenues flow richly, and oppressed by authoritarian regimes. Eventually, Sub-Saharan Africa, the backyard of Europe and its post-colonial heritage is the poorest and most wretched part of the planet, rife with civil war, dictatorships and diseases.

Table 1: The pyramid of poverty below the EU (in $)

Region/country	Per capita income at exchange rates	In comparison to the EU	Per capita income at PPP	In comparison to the EU	ERDI*
EU 15	21.000	100	24000	100	1
8 new member states**	4590	22	10900	46	2,3
Bulgaria + Romania	1730	8	6130	25	3,5
Turkey	2530	10	5830	24	2,3
Western Balkan	1770	8	6770	27	2
Ukraine, Belarus, Moldova	787	3	4700	20	6
Russia	1744	8	6862	29	3,9
Kaukasus	623	3	2760	12	4,4
Central Asia	741	3	3480	14	4,7
Israel	16750	70	19630	79	1,2
Maghreb	1580	6	4260	17	2,7
Machrek	1680	7	3550	15	1,9
Middle East***	3152	12	6830	28	2,2
Sub-Saharan Africa	460	2	1750	7	3,8

* ERDI= Exchange Rate Deviation Index ** without Cyprus and Malta (no data); *** Iran, Kuwait, Saudi Arabia, Yemen (others no data)
Source: Worldbank „World Development Indicators“ 2003; for EU-15 the value given for EMU has been adjusted.

The size of the income gap between the EU-15 and its neighbours is enormous and grows with the distance – with the exception of Israel and some oil exporters with small populations. Measured in exchange rates, the disparities range from 22% of the EU average for the new member states to 2% for Africa. Based on purchasing power parities, the gap diminishes substantially ranging from 46% to 7%. The difference between exchange rate parity and purchasing power parity which is expressed by the Exchange Rate Deviation Index (ERDI) in the last column of table 1, has important implications for the relations between the EU and its neighbours. The higher the deviation is the more attractive is Europe for migrant workers, in particular commuting ones, from the respective country because they can live even on low European wages several times as long in their home country, while European investors can pay low wages there which still allow the employees to live decently because of the multiple purchasing power. Also aid funds spent on local inputs go a long way due to that deviation. Elites in poor countries that can get their hands on revenue from the rich countries, be it aid, export revenues or loans, will be even more tempted to monopolize these (rent) incomes because of its enormous real value in their domestic markets (see below). Catching up thus implies closing that gap by the real appreciation of the local currency which can occur through higher inflation and/or revaluation of the currency. Historically the growth of the external value of the local currency has been responsible for a large share of the overall catching-up process. (Artner/Inotai 1997).

But most countries of the Wider Europe are not only relatively poor, they are often not full-fledged democracies and involved in conflicts. This triple set of state failure is interlinked and mutually reinforcing, as table 2 shows.

Table 2: The interdependence of the three state functions security, welfare and representation/democracy

Impact on / Condition	Security	Welfare	Representation/democracy
Security		Security (peace, monopoly of force, secure property rights) is a necessary condition for welfare. (Collier 1998)	Security (peace, monopoly of force) is a necessary condition for democratic representation.
Welfare	Welfare reduces conflicts and provides the necessary resources to produce security.		Welfare increases the capacity and propensity to political participation (Lipset 1959; 1960; Putnam 1993; Inglehart 1997; Diamond 1999) and prolongs the life expectancy of democracies (Przerworski 2000).
Representation/ democracy	Democracies do not go to war against each other.(Spanger/Wolff 2004) Domestically, they allow the non-violent resolution of conflicts (Hegre 2001, Spanger/Wolff 2004), in particular regarding redistribution (Boix 2003).	Democracies promote (or at least do not prevent) growth Barro 1997:49-87; Przerworski 2000) and social justice (Merkel/Krück 2003).	

The syndrome of interdependent and mutually reinforcing state failures is the consequence of various historic influences including communism (in Central and Eastern Europe) and colonialism (in the Middle East and Africa). It is perpetuated by the actions of powerful societal groups that are benefiting from these structures. Although the specifities vary substantially from society to society in the Wider Europe, a basic pattern emerges that can be described as “authoritarian rent economy”. Societies of that type are dominated by a particular political economy where the state and the ruling elites rely on revenues from rents rather than work, innovation, or income and corporate taxes. Poor taxation weakens representation. Legitimacy is not secured by rules but by patronage. Societies of that type tend to produce instability albeit often artificially concealed by oppression. The monopoly of violence and the provision of security as a public good is often the major state function absorbing most state revenue, and the power base of the ruling elite. Contentious competition for that power and the resources that go with it, is the central political game in many poor countries. Their lack of welfare, freedom and security causes the threats feared by the relatively prosperous and democratic Europe: migration, organized crime (trade in people and drugs, prostitution, money laundering), terrorism (Kitschelt 2004), and diseases. The following table 3 provides some stylised facts characterising these regimes by comparing them with democratic market economies.

Table 3: A comparison of two ideal-type political economies

	Democratic market economy	**Authoritarian rent economy**
Government	Elected, accountable	Self-appointed elites, without accountability and responsibility
Status of citizens	Citizens entitled with rights, in particular to vote	Subjects and victims of violence
Change of government	Competitive, free, fair elections	Heritage, putsch, revolution, regime change
Opposition	Legal parties and civil society, decentralised power	Illegal resistance movements, (regional) *warlords*
Media	Pluralistic, critical	Censored, *gleichgeschaltet*
State revenue	taxes	Rents (Customs duties, commodities)
Beneficiaries of state activities	More or less everybody: (changing) majorities, protection of minorities	Patronage networks based on families, ethnicity, religion or region (nepotism)
Public administration	Rational bureaucracy; occasional corruption	Part of the patronage network, endemic corruption
Major source of income	Labour and entrepreneurship	Access to rents, jobs in the state sector, politically protected and controlled market niches
Shadow economy	Increasing, but still below 20% of gdp	Informal economy is a major pillar of the survival strategies of the population
Foreign economic relations	Open, liberalised	Politically controlled, important source of rents

Of course, these stylised facts paint a black and white picture. Actually, many advanced democracies, e.g. Italy, show (increasingly?) signs of clientelism, patronage, corruption, tax avoidance, shadow economy etc. behind a façade of media democracy that prevent efficient and transparent governance. There are also “legitimate” forms of rent-seeking in advanced economies, e.g. patents, or intellectual property rights. All advanced democracies substantially regulate their economies in a way that benefits certain segments of society thus creating “rents” if compared to the incomes derived from an unregulated, ideal-type market economy. Still, they are much closer to that ideal-type democratic market economy described in the second column of table 3 than most of the societies in the EU’s neighbourhood. Within the Wider Europe, the degree to which societies fit to the “ideal-type” authoritarian rent economy described in column 3, varies substantially, too. Politically, they range from dictatorships like Syria, Libya, Saudi Arabia or some Central Asian republics to semi-authoritarian regimes such as Algeria, Jordan, Egypt, Belarus and more or less defect democracies (Merkel 1999) like Albania, Russia, Ukraine, the Caucasus republics or Turkey. Economically, post-communist societies tend to be more industrialised and tax-based with relatively open economies and a rule-based public administration. Less developed countries in Central Asia, the Middle East and Africa depend much more on revenues from commodity exports and aid which in turn feed their patronage systems. Since 1990, both, political and economic liberalization has advanced albeit more in the former communist countries than in the South. The following table 4 gives an overview on the progress of transition towards a democratic market economy within the wider Europe.

Table 4: Transformation Index (Bertelsmann)

Region/country	Political Transformation	Transformation towards market economy	Status-Index	Management-Performance
8 new member states*	4,9	4,6	9,5	8,6
Bulgaria + Rumania	4	3,5	7,5	7
Turkey	3,4	3,3	6,7	7
Western Balkan **	3,4	3,1	6,5	6,1
Russia	3	3	6	5,6
Ukraine, Belarus, Moldova	2,3	3	4,6	3,8
Kaukasus***	2,2	2,5	4,7	3,8
Central Asia****	2	2,3	4,2	3,2
North Africa*****	1,8	2,6	4,4	3,5
Middle East******	1,5	2,3	3,8	2,6

*without Cyprus and Malta (no data),
**Bosnia-Herzegovina, Albania, Croatia, Macedonia, Serbia and Montenegro,
***Georgia, Azerbaijan, Armenia,
**** Afghanistan, Bangladesh, Nepal, Pakistan, Uzbekistan, Turkmenistan, Kyrgyz Republic, Tajikistan, Kazakhstan,
***** Marocco, Algeria, Tunesia, Libya, Egypt
****** Lebanon, Iraq, Iran, Saudi-Arabia, Yemen, Syria

Values range from 1 – 5 (democracy and market economy) and 1 – 10 (transition management); the Status-Index = democracy and market economy;
Source: Calculations by Franziska Riegelmann based on http://www.bertelsmann-transformation-index.de/11.0.html

Any attempt to stabilize these societies has to take into account the political economies they are based on. Although of different size, there is always a modern sector that largely follows the rules of the formal global economy. But it often consists of foreign investments, mostly in the raw materials sector and, to a lesser extent in manufacturing and services. Besides the modern formal sector, there is a huge informal sector including subsistence agriculture. The output of that informal sector allows many people to survive on extremely low wages. The public sector follows formal rules. Since they are often ambiguous and not sufficient or applicable, they hardly veil endemic corruption and clientelism that define the true rules of access to public goods. As this paper will argue, most policies of rich democracies assume markets, administrative and political structures that work rationally and follow the rules, and thus are bound to fail or to produce unintended consequences.

Exporting stability – some history and basic philosophy

Oppression and inequality are a hotbed of conflicts that lead to civil war and terrorism. Traditionally, the rich countries of the EU (or, more generally, of the OECD) have cared little about state failure in its three dimensions (security, welfare, representation). First, there has been less state failure in the past (before 1990) as the super powers stabilised their clients during the Cold War. Conflicts tended to be conflicts between proxies with one bloc supporting the government it was allied with and the other the opposition/liberation/resistance movement. Second, the threat most feared was communism, i.e. the risk of a failing state to turn into a communist regime allied with the Soviet Union (or China). Subsequently, efforts to stabilize allied regimes focused first on security, second on welfare, and only as a distant third, on democracy. Military aid and intervention were used to achieve the first goal. As an additional policy, development assistance evolved out of the American effort to stabilize the front-line countries of western Europe and South East Asia. In the case of Europe, development cooperation mostly continued policies from colonial times (public investment, preferential trade arrangements, administered prices for exports). Democracy promotion was used as a pretext to undermine communist dictatorships rather than as an universal rule though it gained momentum in the 1980s with, among others, the foundation of the National Endowment for Democracy by the US government and the activities of German political foundations in Portugal and Spain..

After the collapse of communism, the policies of western countries, and of the EU in particular, changed as the neighbouring countries started their ambitious reforms. The end of the Cold War reduced the international support for many authoritarian regimes in the developing world and opened up new opportunities for democratisation. At “the end of history”, democracy and market economy have appeared as the panacea to all the problems of the world. Given the interdependence of democracy and prosperity (see table 2 above), turning all neighbouring countries into democratic market economies has seemed to be the optimal way to produce stability. The post-communist transition countries formed the avant-garde of that supposedly global process.

If it ever had ended, history resumed its disorderly course on September 11, 2001. At least for the USA, a new global confrontation had begun that led to a new containment strategy, best expressed in the National Security Strategy of September 2002 (White House 2002). Although still advocating the double approach of democratisation and free markets, the war against terrorism weakened the actual commitment to democracy and human rights within both the rich democracies in the name of homeland security and those countries whose authoritarian regimes were valuable allies (e.g. Pakistan, Egypt). It also became clear, that the development in many countries did not follow an orderly transition towards democracy. In many cases, societies remained stuck in constellations like “feckless pluralism” or “dominant-power politics” (Carothers 2002) or, even worse, collapsed into violent conflicts and civil war.

The latter added a new dimension to stability export: military intervention for humanitarian reasons and to change regimes. The forceful removal of dictators or elites blocking conflict resolution, development and democratisation complemented the traditional tool set of non-violent democracy promotion and economic cooperation. It led to the establishment of protectorates where rich democracies not only provided assistance to correct the two core state functions of welfare and representation (e.g. by financial cooperation or election monitoring) but also to assure the third function of security thus limiting severely the sovereignty of the occupied countries and returning to an, albeit liberal, imperialism. But Europe with the exception of France and Britain has been a reluctant interventionist. Its strength and influence relies more on economic than military power.

Which actors and policies are used to export stability by ensuring welfare, democracy and security in the poor partner countries? While democracy and security are promoted largely by government policies, possibly complemented by some activities taken by organisations and institutions of the civil society, welfare results from a much larger range of interactions between rich and poor countries. Public policies include multilateral policies (by the UN, World Bank, IMF, WTO etc.) that provide not only financial and technical assistance but create a regulatory international environment that interferes substantially and deeply with domestic economic policy. Those multilateral activities are complemented by bilateral public policies that also co-shape the economic development of the partner countries. The regulatory and policy framework created by multilateral and bilateral cooperation is filled by the activities of private enterprises (banks, investors, traders etc.). Most public policies are designed to lead to a specific behaviour of the private sector, i.e. above all promote trade and investment. Actually, some private sector activities might rather harm than increase the welfare of the partner countries. In any case, most transnational activities, be they private or public, affect different groups and segments of the partner societies and economies differently, and will, in particular, redistribute wealth and income not only between but also within countries. Those effects usually lead to political conflicts that need further political management on the national or international level.

The last decades of international cooperation were dominated by a set of mostly liberal economic ideas, the so-called "Washington Consensus". It called for fiscal and monetary discipline, a competitive exchange rate (usually implying a devaluation of the local currency), liberalisation of trade and capital flows, in particular foreign direct investment (fdi), tax reform and restructuring public expenditure (from consumption to investment in infrastructure, health care and education), deregulation, and privatisation. After the Asian crisis of the late 1990s and the disappointing performance of Latin America the Washington Consensus has been modified by adding and stressing institutional and social measures.

Traditionally, the EU has used several instruments to promote stability, economic development, and democracy: aid, trade policy, and political dialogue. These tools made up the backbone of the big cooperation schemes such as the Lomé Convention and its successor programs (Cotonou) towards the ACP countries, the Barcelona-process towards the Mediterranean, the Europe agreements and the trade and cooperation agreements with the ex-communist countries of Central and Eastern Europe.

- Aid has been given in various ways, as technical assistance or as financial cooperation (grants and credits). It can assist partner countries to fulfil all state functions better by helping with better economic and social policies or promoting democracy. In some cases, the arms-length approach of these traditional instruments seemed insufficient when it became clear that local power structures prevented sustainable successes.
- Trade preferences have been offered, though often excluding agriculture and other sensitive industries.
- Political dialogue has been an approach to change policies and political conditions in order to make aid more effective. Donor coordination has been supposed to give that approach more leverage. In some severe cases of conflict and post-conflict situations, the EU went even further and committed armed forces to protect endangered people and allow other aid efforts to work. For a few European countries (first Greece, Portugal and Spain, later the ex-communist countries of Central and Eastern Europe), the offer of EU membership has been <u>the</u> major instrument to promote the transition towards democracy and market economy.

Even more recent policy papers (Rasmussen 2003) do not go far beyond the scope of these traditional policies and approaches.

The EU's toothless toolbox for stability export

The state of the EU's neighbourhood hardly witnesses the EU's great successes in exporting stability. Why have its tools been so ineffective? This section looks at the seven most important instruments namely trade liberalisation, foreign direct investment, migration, aid, political dialogue, enlargement, and protectorates. The order is not coincidental. It reflects an increasing depth of involvement with a partner country's economic and political development. To some extent, the use of the stronger tools originated from the donor's frustration with the ineffectiveness of weaker instruments.

Trade liberalisation

Free trade and trade liberalization allowing free trade has been presented as a panacea by the liberal mainstream of development economics and politics. It is the corner stone of most grand schemes offered to poor countries starting from the Lomé Convention of the 1970s, and the General System of Preferences, up to the Barcelona process and all agreements between the EU and ex-communist countries of CEE. It is central to the new US Security strategy and figures high on the agenda of the American Greater Middle East initiative. Its theoretical basis is the classical theory of international trade by Ricardo (trade between Portugal and England with the former specializing in wine and the latter in textiles) and refined thereafter. Already when referring to that theoretical basis, politics usually neglects crucial conditions and consequences like the actual possibility to specialize (e.g. extending the production of wine), the failure to translate productivity growth in output growth with subsequent unemployment, and the distributive conflicts between and within countries. Unskilled workers in rich countries should oppose liberalisation, those in poor countries favour it (Reuveny/Li 2003: 579). Capital owners should react in the opposite way.

Actual trade policy proofs that politics does not trust its own ideology. Most rich countries are protectionist and seldom offer market access without reciprocity although trade theory would recommend it. Virtually all successful development processes (e.g. Western Europe, Japan, Korea, Taiwan) have relied on selective protectionism and export promotion rather than free trade. The quest for free trade has almost always been the policy of the most advanced rich hegemonial economies like the UK before 1930, the US after 1945, or the EU since the 1970s. One of the few exceptions have been some transition countries in Central and Eastern Europe, notably Estonia, that have abolished trade barriers unilaterally.

Trade policy as a tool for exporting stability comes in two components: 1. offering (preferential) market access to a partner country to be stabilized. 2. requiring the partner countries to dismantle their own trade barriers. A variant of the second policy is suggesting trade liberalisation among several partner countries. The latter seems less self-serving as it offers more market opportunities to other poor, less competitive countries rather than the advanced economy. Let us consider both policies more closely.

1. Giving market access is certainly a potentially good policy. It might be useless and particularly painless for the donor if it is limited to products a poor partner country is not able to supply (e.g. abolishing custom tariffs on airplanes from Africa). Clearly, it helps in the short term only if a competitive production in the partner country already exists that can be expanded to meet the additional demand created by the lowering of the EU's trade barriers. In the long term, it might provide an incentive to start production of the respective goods and services because of the better market access. But again, the viability of that investment depends to a large extent on a wide range of other factors. If these conditions of "systemic competitiveness" (Esser et al. 1992) are not given, more market chances are of little effect. Lowering tariffs offers anyway but diminishing returns because overall levels of protection have come down to very low

levels during the past rounds of global trade negotiations. Other measures could reduce the prices of the poor countries exports in a much simpler way, e.g. the devaluation of its national currency (Vice-versa, an appreciation of the national currency, possibly as a consequence of increased exports, might reverse the impact of lower tariffs on the price within the rich markets).

2. Trade liberalization by poor partner countries offers advantages to producers in the rich countries of the EU and to consumers in the poor countries. By the way, export subsidies like the notorious Common Agricultural Policy, which liberals love to hate, have the same effect. The justification for trade liberalisation lies, however, in the presumed increase of productivity and competitiveness. That desired outcome is expected to result from competitive pressures on the now exposed domestic producers and the lower costs of imported inputs. Both effects might be mitigated or reversed when higher imports lead to a decline of the external value of the local currency (i.e. devaluation). However, there is no substantial evidence of trade liberalization leading to higher growth (Rodrik 2001a). Another side effect is the reduction of government revenue from customs duties. Import duties make up a relatively high share of total tax revenue in many poor countries, particularly in the Arab world. Tighter budgets could lead to a decline of public spending and of the supply of public goods and services which in turn could damage the competitiveness of local producers that rely on those inputs. In many cases trade liberalisation has led to higher budget deficits and increasing debt (Khattry 2003). More generally, getting the state out of regulating trade might weaken the state's overall capacity to manage economic and social development (Rodrik 2001a).

   Because levies on trade are also a source of rents (e.g. by granting exemption from import duties to special interests) and feed often corruption, it is also expected that liberalisation would reduce those opportunities and lead to leaner and cleaner governance. However, tariff duties are less prone to bureaucratic and autocratic meddling than import quotes or licensing. The more democratic regimes are, the less they tend to use licensing and the more liberal their trade policy tends to be (Martin 2004) because in poor countries, the abundant production factor, unskilled labour, should benefit from freer trade, and it should also be the majority of the voters (Reuveny/Li 2003). With declining inequality in the wake of trade liberalisation, the chances of democratisation should rise. (Boix 2003: 142-143). There is also evidence that increased international integration reduces corruption in those more open and integrated countries (Sandholtz/Gray 2003).

In the end, the weak effects of trade liberalisation can hardly surprise. The overall welfare effects of free trade are largely exaggerated let alone equally distributed (Weisbrot/Baker 2002). The EU has anyway been rather protectionist. Where market access has been offered, poor countries could seldom use the opportunity. The biggest beneficiaries have probably been foreign investors that used appropriate locations that were granted trade preferences as intra-company trade makes up a large and growing share of international trade.

Foreign direct investment

Foreign direct investment (fdi) thus seems to provide a way out of the impasse of underdevelopment when market access cannot be used because of the lack of competitive domestic suppliers. Foreign investors bring not only capital which local entrepreneurs could also have borrowed, but know-how regarding production techniques, quality, marketing, and management in general. A couple of international success stories are based on attracting lots of foreign investment: Hong Kong, Singapore, or more recently and closer to the EU, Ireland, Hungary and other countries of Central and Eastern Europe. Although a high level of fdi seems to be a sufficient condition of rapid growth, it is by no means a necessary one. The effects of fdi on successful development are often overestimated, particularly in poor countries (Kosack/Tobin 2003; Nunnenkamp 2004). Japan, Korea and Taiwan, for instance, have largely forgone foreign investment during their catch-up development.

And perhaps wisely so. Fdi carries a hefty price tag that might well be higher than borrowing on the international financial markets though less risky in the case that an investment project fails to generate profits. Ireland proves that. It has relied on massive inflows of fdi which it attracted by offering low corporate tax rates, a cheap and educated (English-speaking) work force, decent infrastructure, and a range of other business-friendly policies. Part of that attractions has been achieved by using EU regional aid cleverly. When these investments started to produce on full scale, Ireland turned within years from one of the poorhouses of the EU into its second richest economy – measured in gdp/capita. But an increasing share of the value added within Ireland, i.e. its gross domestic product, went to the foreign investors reducing the share of wages to the unusually low level of 58% (while the, also declining, EU average is about 78%) and putting its gross national product, i.e. the income of the Irish citizens, at a level of about 20% below its gdp. Irelands success thus remains above all the success of the tax-avoiding foreign investors at the expense of other countries' and Ireland's treasuries and Irelands workers (Dauderstädt/Witte 2001). Still, this strategy might be the best way out of poverty. But it will be difficult to replicate for large countries without an English-speaking workforce and governance structures that learn even slower than the Irish whom it took almost 20 years after EU accession to start their economic miracle. In Africa, for instance, investment has little impact on growth anyway with more capital simply leading to lower returns (Devarajan/Easterly/Pack 2003).

Migration

As some development economists have pointed out, migration could be a substitute for trade and capital flows which would boost global growth more than any other measure (Rodrik 2001b). Migrant workers in developed countries tend to have a higher income than in their countries of origin though usually lower than the average income in their host countries. That income reflects a productivity which is much higher than the one they could achieve in their country of origin. Most of the migrant workers transfer part of their income to their home countries as remittances which sometimes make up a substantial share of the foreign exchange earnings of these countries. However, the countries of origin loose valuable, often relatively qualified and motivated human resources through migration. In some cases, the involved brain drain can hamper development.

Migration has ambiguous effects on the host countries, too. Immigrant workers compete to some extent with unskilled, often unemployed workers in the EU though they often accept work European workers refuse to take on. Their contributions to social security systems and taxes usually outweigh their demand for public goods and entitlements. Some economists, however, fear an overstretch of European social systems due to migration that wants but to benefit from the welfare state (Sinn 2000). Migration is often expected to alleviate the pressures on pension systems in Europe. As long as there are unemployed Europeans, that policy remains doubtful. Anyway, a more liberal immigration policy seems highly unlikely given the political opposition in most EU countries.

Aid

The EU is the biggest donor of official development assistance (oda), if one includes both bilateral aid of member states and the aid managed by the EU as supranational body. Given the different priorities of bilateral aid and the lack of coordination, the image of the world's biggest donor is exaggerated. The true priorities of EU spending are better illustrated by the fact that the EU spends 918 USD on each European cow and only 8 USD on each human being in Africa (Wolf 2004).The assistance of the EU proper is heavily criticised. The former British secretary of state for international development, Clare Short, called the Commission "the worst development agency in the world" (Santiso 2003: 4-5). Certainly, the abysmal record of the major recipients of both, bilateral and multilateral, European oda, notably Africa, supports the negative assumption that aid will not bring about development.

That assessment is by no means new but goes back to liberal critics (Bauer 1981) and it is corroborated by large studies by major donor agencies (World Bank 1998; 2001). The poorer countries are and the lower their Human Development Index is, the less they benefit from aid (Kosack/Tobin 2003). Actually, aid might often do more harm than good. It also might benefit certain special interests in the donor countries which provide the goods and services, the aid is spent on, more than the recipients. If it is financial aid in the form of loans, it increases the debt burden. Aid is also an additional source of rent income that feeds patronage systems. In the end, the productive use of aid depends largely on the cultural-political environment on the recipients' side. It has a positive impact when the recipient government is truly committed to development and has adopted appropriate policies (good governance) which it can make work not only in its immediate reach but throughout the country.

The international and the European aid community has basically accepted these criticisms and re-focused its assistance on good governance, democracy promotion and human rights. It has introduced conditionality in order to force or provide incentives to partner governments to adopt development-oriented policies, fight corruption, and start or continue processes of democratisation. Unfortunately, the EU has been particularly unsuccessful although it has increased its commitments to democracy assistance substantially (Santiso 2003).

Policy dialogue

Trade, private investment, and aid will accelerate the development of partner countries only if their national governance is good. Donors have tried to improve governance by a variety of instruments under different labels such as conditionality, policy dialogue, or democracy promotion. The International Financial Institutions, notably the International Monetary Fund (IMF) and the World Bank have led this approach by insisting on a policy mix that has been called "Washington Consensus". The EU has followed this lead rather than developing its own agenda. Lack of coordination has undermined its leverage (Santiso 2003) although the end of the Cold War has increased donor coordination (Boyce 2002).

Policy dialogue has never been the technocratic exercise it was supposed to be. Since all policies reflect different values and interests and usually affect the distribution of income and wealth, there is no single good policy. The choice of policies is a deeply political one that may decide upon the survival of governments and social peace in a partner country. When donors are interested in the fate of specific governments or political forces within partner countries, they have to take these effects into account. Thus, donors will be reluctant to force upon partners who are important for geopolitical or economic reasons, policies that will undermine their power (Dauderstädt 1988). Often the policies suggested by donors have unintended and unforeseen consequences. The technocratic economic models used by the Fund and the Bank in particular do often not grasp the full and complex cultural, political and social reality of the partner countries (Thirkell-White 2003).

As Fukuyama has pointed out in a recent article (Fukuyama 2004), donor conditionality in the spirit of the Washington Consensus has often reduced state capacity in a detrimental way. Instead of limiting the scope of state functions they have led to a reduction of the strength of state institutions. Trade liberalization has often accelerated that process by squeezing public budgets. The true challenge lies in the transfer of institutions, in making public service and judiciary work, and in committing the elites to self-sustaining development.

Democracy assistance is often seen as complementing a policy dialogue that is supposed to lead to good governance. Democracy is expected to provide a more stable environment for economic policy and guarantee important rights. There are, however, potential conflicts between liberal values (minority rights, property rights) and democracy (will of the majority). In societies with deep cleavages (be they ethnic or economic), majoritarian rule would probably lead to oppression or massive redistribution. Corresponding fears of the respective minorities would induce them to resist democratisation or to try to change the democratic regime (Boix 2003; Lijphart 2004).

Most of the countries of the Wider Europe are deeply divided. The ruling elites (sometimes ethnically defined) control most of the wealth. Policy dialogue has to tread carefully in that minefield. On the one hand, if it cannot get and maintain elite support for the reforms it suggests, it is bound to fail. On the other hand, elites will hardly support measures that undermine the sources of their power and wealth.

Enlargement

Compared to the weak record of the above discussed instruments and policies, EU enlargement has been a relative success story. In the 1980s, it has stabilised the young democracies of Greece, Portugal and Spain. In the 1990s, it induced eight Central European transition countries and seems to induce the remaining ex-communist Balkan countries (certainly Bulgaria, Romania, Croatia, Macedonia, probably Albania and possibly Bosnia and Serbia, too) and Turkey to adopt wide-ranging reforms that have turned or will turn them into democratic market economies. The process is surprising from both sides. Originally, in 1989/1990, the EU was hardly inclined to accept the ex-communist countries as member states. It pursued enlargement rather reluctantly in spite of the lack of popular support and driven by elite interests and precipitate promises by its politicians who lacked alternative options to offer the transition countries (Lippert 2000). On the side of the candidate countries, there was an enormous lack of knowledge regarding the true nature of the EU, its institutions and policies. In the rush of the "return to Europe", hardly anybody questioned the sensibility of the accession strategy. Only hard-core liberals (Achten 1996; Jamieson/Szamuely 1998; Belke/Hebler 2002) and some cautious supporters of active developmental strategies (Amsden 1994; Eatwell 1997; Dauderstädt 1998) openly warned the ex-communist countries: the former from joining a sclerotic and over-regulated EU, the latter from giving up too fast important policy options that had proved effective in other countries which had succeeded in catching up, like the East Asian tigers.

The dynamic interaction of domestic transition and European integration produced mixed results. Democracies became or remained relatively stable in spite of fragile party systems, wide-spread disgruntlement with the way democracy worked and, as a consequence, frequent changes of government (virtually no governing party or coalition was ever re-elected in Central and Eastern Europe between 1990 and 2004). Market economies were established though the variety of capitalism chosen had to be compatible with the EU's *acquis communautaire* which was less liberal than Estonia's first choice and possibly more liberal than the preferences of many East Europeans suffering from rising unemployment and inequality. Generally, growth has been underwhelming and unsteady, not at least because of several debt and exchange crises (e.g. in the Czech Republic and Hungary in the mid-1990s). The income level of 1989 has been regained very slowly and in some transition countries not even by 2004. In many regards, though more pronounced in those transition countries that did not join the EU, transition has led to peripherisation (Müller 2002) i.e. transforming the ex-communist countries into locations of low-income production dependent on transnational production networks dominated by rich countries and their multinational enterprises.

Nonetheless, the attraction of EU membership, however ill-conceived, has been sufficient to make the candidate countries to accept the reforms required by the EU and to partially give up hard-won democratic sovereignty in favour of a share of voice in the less democratic EU system of multi-level governance (Böröcz 2000). The motivation beyond the fog of historic rhetoric has been less clear. Economic integration was already well advanced under the association regime. Access to EU funds has been an incentive though not a very convincing one given their low effectiveness in other periphery regions of the EU. Participation in EU decision-making which affects the neighbouring countries strongly would have been a good reason. Another reason often given has been that preparing for accession required policies that were anyway desirable but easier to sell to the public as part of the *acquis*. It remains to be seen how electorates react when some of the expected advantages do not materialise and the losers become more vocal (e.g. in Poland).

On the EU's side, the scepticism of the early years has to some extent returned. In the mid-1990s, after granting all associated ex-communist countries the right to accession, the EU had stopped to conclude further association agreements. Only by 2000, the EU offered new opportunities to the western Balkan countries and Turkey, albeit with many reservations. After the big-bang enlargement, enthusiasm in favour of further enlargements is still more muted. The losers (net contributors, treasuries angry about tax competition, and workers in declining industries) are more and more complaining. A more rational enlargement policy in the first place might have been more credible, too. Instead of discussing cultural or geographic "final" borders, criteria could have been adopted that reflected more directly the true problems of the EU like a minimum level of per capita income (say 75% of the EU average) and/or unemployment. Applying these criteria would have delayed the present enlargement but offered incentives to all neighbours not only to reform their polities and economies but to push for growth and employment.

Enlargement benefited from the – possibly irrational – preference for accession of the elites who ruled the neighbouring countries. In other countries that powerful leverage was not used. It is debatable if a more generous and earlier offer of membership to the Balkan countries and/or to other republics of the former Soviet Union might have prevented the conflicts and problems that have emerged there. Possibly, some of the more authoritarian and nationalistic elites would not have been tempted anyway. Beyond Europe, accession was principally no option.

Protectorates

In some conflict zones, where even genocide had to be feared, the EU (in cooperation with NATO and/or UN) intervened and used force in order to protect human lives and rights, to impose democracy, and to promote reconstruction and development. The ensuing protectorates in Bosnia, Kosovo, Afghanistan, and partially and temporarily in Albania, Macedonia and some African countries had mixed results.

Politically, the intervening powers continued to remain the rulers of last resort, cancelling laws made and decisions taken by democratically elected domestic bodies if they opposed their goals and principles. The resulting regime has been called liberal imperialism or absolutism by some observers (Knaus/Martin 2003; Schwarz 2002). On the one hand, maintaining a state apparatus composed of expatriates from rich countries has proved enormously expensive and cumbersome (Dauderstädt 2003). On the other hand, returning power, even on a low administrative level, to the less criminal but rather technocratic segments of the old elites that had been regarded as mainly responsible for the conflicts, oppression and human rights violations, has been hardly acceptable, though often unavoidable in the end.

Economically, the protectorates produced artificial economies depending on aid and the spending power of the occupation forces and administration. A rent-seeking economy of a special sort emerged (Ehrke 2003). Prices of goods and services demanded by the occupants rose dramatically, and, subsequently, the income of those locals who could supply them (owners of decent housing, English-speakers, taxi drivers, body guards etc.). Locals with local income lost purchasing power and relatively impoverished. The use of labour and capital was switched to serve the occupants' needs. A shift back to an export-oriented and self-sustaining development seems more and more illusory. The local currency is over-valued due to continuous inflows of capital and inflationary pressures stemming from the occupants' demand overhang. The economy sucks in imports and has no competitive exports to offer.

In security terms, peace could be largely maintained. But the EU is hard pressed to keep these occupation forces in place let alone build up capacities to intervene in more distant countries, possibly against local resistance. The Iraq experience has discouraged further experiments with imposing democracy by military means.

Table 5: The toothless toolbox

Instrument	Impact on state functions			EU attitude
	Security	Democracy	Prosperity	
Trade liberalisation	0	(+)	(+)	+ others/- own
Fdi	0	(+) liberal rights	+	+
Aid	0	+ formal/- material	0	(+)
Migration	0	0	+	-
Policy dialogue	0	+ formal/- material	0	+
Enlargement	+	+ domestic/- EU	+ ?	-
Protectorate	+	-	-	-

0 means neutral, + positive, - negative

Table 5 above tries to summarize the findings: The instruments available in the EU's toolbox are not very efficient. Some of the more efficient ones (migration, enlargement), the EU will hardly be politically ready to use on a larger scale (see last column). Regarding democracy, many instruments have mixed effects. They might formally strengthen domestic institutions, rules and/or rights, but shifting material power to foreign actors. In the best cases, these actors are multilateral agencies, notably the EU itself, which show the usual democratic deficit of all institutions of global governance. They are hardly subject to judicial or parliamentary scrutiny, the executive power is correspondingly unaccountable and intransparent, and the voting powers reflect state power rather than people power.

Options of a reluctant and helpless hegemon

How to improve on that record? Which other instruments and policies might be more apt to bring stability to the EU's neighbourhood? And are these other means likely to find the political will and necessary resources within the EU?

One should start with a note of caution. Stabilizing other countries from abroad is never easy. In many neighbouring countries, the EU is facing a conundrum of mutually reinforcing problems that have grown through a long history and will not change easily in the short term. Interfering with local developments can cause as much harm as it may do good. But the EU will exert anyway a strong influence on the development of its neighbourhood not only by deliberate policies but by the interaction of markets and societies. To shape these relations in a way that reduces risks and increases the chances of stability would be an important first step.

The EU is looking for policies to stabilize authoritarian rent economies and to transform them into peaceful democratic market economies. In the short term, there might be a dilemma as that transition implies a certain amount of destabilization. Regime changes seldom occur without disruption. The post-communist transition was exceptional in this regard, but only in some Central European countries. The nation-building within the collapsed federations of the former Soviet Union and Yugoslavia was already troublesome and conflict-prone. In the Arab world and, to a lesser extent, in Africa, societies suffer from enormous tensions that threaten to become explosions if they are released in an uncontrolled way. Change should occur as rapidly as possible because it is driven by the emergence of threats, but also as slow as necessary. The state failures have to be corrected without creating new and worse ones. Pragmatism should prevail over an ideology-driven insistence on ideal-type reforms such as elections and free markets without sufficient institutional and societal foundations.

Security

Europe does not have to fear conventional threats to its territorial integrity. The threats emerge from either the lack of government control over threatening groups within partner countries or deliberate encouragement of such groups by governments (e.g. state-sponsored terrorism). In the latter case, Europe can and should use its hard and soft power to discourage and deter those governments from continuing that policy. In the more wide-spread former case, Europe should strengthen the security apparatus of the partner governments but on the same time insist on the respect of human rights. Except in extreme cases of genocide or already open violent conflicts and civil war, Europe should not intervene militarily and not give military assistance to one of the sides of a domestic conflict. European policies aiming at strengthening the security of and within partner countries should focus on human security. A study group headed by Mary Kaldor has developed criteria and objectives, and assessed the necessary capacities to achieve these goals (Glasius/Kaldor 2004). If military means are used they must be closely coordinated with civilian measures to stabilise the situation.

The monopoly of force is the defining core function of a state. Since there are few alternatives to states for the management of many threats, that function has to be maintained and protected except in the above mentioned extreme cases. In particular, there is hardly any chance that democracy or prosperity will evolve without security (see table 2 above). Thus, security (or peace) should be the immediate priority even at the transitional expense of democracy or market economy. However, Europe should insist on and assist to the liberal exercising of that state function. European diplomacy should require governments to have civilian control over the military, and proper judiciary and parliamentary control over all security forces. Human rights should be part of the rule of law. European aid can help to train state employees on all levels (from generals and ombudsmen to police officers) to adopt the appropriate measures.

Democracy

Democratisation should be a long-term goal rather than an immediate concern of European stability export. There are many ways to consolidate young democracies and to support the improvement of defect democracies ranging from diplomatic measures to democracy assistance (Carothers 1999, Burnell 2000, Diamond 1999, Youngs 2002). The institutions of the more or less democratic state and those segments of the civil society that are supporting the democratisation can be strengthened through advice, support in kind or money, and linkages to like-minded partners in the world. The sub-fields include promotion of the rule of law (co-operation with judiciaries and law enforcement agencies), support for political parties, election monitoring, independent media, local and regional government etc.. All these approaches are feasible and actually part of the EU's approach where partner countries are at least slowly opening up or already open.

The promotion of democracy gets the more difficult the less the current regime is open and the slower it is introducing liberal reforms. In the present global political climate, most regimes have at least started with some reforms, often in the field of economic policy. Foreign actors should use low-profile approaches such as non-governmental organizations, local partners, indirect funding and avoid premature insistence on human rights and elections in order to promote more openness (Dalpino 2000). Approaches must be carefully adapted to the specific relationship between authoritarian regimes and their societies which might not always be ready for democracy (Burnell 2004). Economic sanctions are ambiguous. As far as they lead to less growth, they undermine the long-term prospects of democracy. In the short term they might harm the innocent majority but also reduce the economic resources at the disposal of ruling elites, in particular drying up the international sources of rent income from aid or commodities. But Europe will forego the supply of commodities only in some rare instances when they can be easily substituted like in the case of "blood diamonds" from Africa. Boycotting Saudi Arabian oil is hardly a realistic option for promoting democracy there. A less radical measure could be to collect data on international revenues (like aid and royalties from commodities) of the ruling elites and make them publicly accessible, also to citizens of the partner countries. Informed citizens will probably ask for a less egotistic use of these funds.

Elections rarely are the beginning but rather the end of democratisation. They should usually start at the local and regional level where a structured public sphere exists, and issues and candidates are well known. On the national level, they need more preparation: In the case of divided societies, credible constitutional safeguards against the oppression of minorities have to be established; political parties have to be created with clear programmatic profiles and a sufficiently qualified cadre of politicians and experts to offer a realistic choice; media should cover the campaign in a way that allows voters to develop their views and take an informed decision. The administrative process of voter and candidate (party) registration and election management and supervision must be transparent and accountable. A doubtful election undermines the legitimacy of the so elected parliament and government.

But the chances of democracies to develop and survive are small if the basic societal and economic conditions are missing. The probability of democratisation and/or the life expectancy of democracies rises when distributional tensions are low because either income and wealth are not extremely unequally distributed or the assets are unspecific, i.e. not easily expropriated or highly taxed. Societies with a very unequal distribution of very specific assets like land or commodities are unlikely to become stable democracies (Boix 2002). Furthermore, legitimacy results not only from due process but also from favourable outcomes. Good governance, that provides growth and social justice, is the best way to stabilise democracies (Przerworski 2000). In the long run, rapid growth will lead to modernisation, urbanisation, more education and information and eventually more participation, as the East Asian countries (e.g. Korea, Taiwan) have shown.

Prosperity

Economic development is obviously a corner stone of stability. Promoting it should be a central goal of all policies aiming at exporting stability. Europe however seems hardly be in a position to offer a model. Its own growth is weak with the possible exception of Ireland. But a strongly growing European economy would probably be the best help Europe could offer to its neighbourhood. When Western Europe grew rapidly in the 1950s and 1960s convergence within Europe was strongest with countries like Greece, Portugal or even Poland catching up faster than during the 1980s (Dauderstädt/Witte 2001). A booming EU economy would offer markets for goods, services and labour. Resistance against the necessary adjustment required by the development of its poor neighbours, would be much weaker. Europe would be more willing and ready to use the most effective policies such as more open markets, a liberal immigration policy and further enlargement.

Since the mid-1970s, globalisation and the economic development of poor countries have destroyed millions of jobs in agriculture and manufacturing in the developed world, mostly in the USA, but also in Europe. The losses have been concentrated in industries using lots of unskilled labour (e.g. textiles, apparel, leather goods) and those targeted by developing countries' strategic industrial policies (e.g. cars, electronics), but occurred in all industries because of lack of demand by the poor countries in the wake of the debt crisis (Kucera/Milberg 2003). Above all in the USA, these losses have been compensated for by new jobs, mostly in services. Europe has been slower. The difference is probably due to a less expansionist macroeconomic policy that fails to translate productivity into output growth. Thus, better macroeconomic management to ensure growth at home and to prevent debt crises in partner countries (like in the Czech Republic and Hungary in the mid-1990s) is a key policy to achieve prosperity. Such a policy should include the control of speculative capital flows and of overshooting exchange rates which should be easier thanks to the Euro. Europe should not avoid having trade deficits vis-à-vis neighbouring countries and tolerate a slight real undervaluation of their currencies. Commodity exporters will have difficulties to achieve this without using a mix of import duties and export subsidies to correct the impact of the Dutch disease.

The partner countries also have to improve the meso-economic and structural conditions for growth. It is not simply "free markets" that produce competitive companies but a socio-political environment which reduces risks, transaction and information costs and fosters trust. Aid can try to assist in developing institutional structures and building capacities but it will be difficult as it interferes with local power structures and mentalities that are often based in long histories. Financial aid should primarily support investment in education and health. It should aim at rising the productivity of the poor further by improving their access to capital and land. Informal property titles should be formalised so they can be used as collateral (De Soto 2001). Agricultural land should be redistributed to reduce inequality which in turn makes democratisation easier (Boix 2003).

Europe could accelerate the slowly emerging legalisation, liberalisation and re-regulation of its markets for drugs and prostitution. This would create new markets and jobs for suppliers from poor countries in the formal economy (as opposed to the shadow economy), reduce opportunities for organized crime, increase tax revenues and free police forces to deal with really dangerous threats.

Conclusion: the failing hegemon

Europe itself is a failing state, albeit one that never worked in the first place. It continues to have a democratic deficit although it has strengthened the role of the European Parliament over the last decades. It is rather unlikely that the enlarged EU will achieve a more effective democratic governance let alone get a federal government accountable to its citizens (Siedentop 2000; Boix 2004). Economically, it has mostly performed worse than benchmarks like the EFTA countries (until they joined the EU in 1994) or the USA or Japan. That overall moderate performance hides a great diversity of different national performances which the EU could not really use to spread best practices. Its best record concerns the security dimension. The EU has prevented wars within Europe since 1945 with the exception of a few civil wars. But the EU's contribution to internal security has traditionally been weak as home affairs have remained a prerogative of the member states.

These failures make Europe ill placed to export stability to its wider neighbourhood. With regard to public policies, it lacks the resources and the political will to pool the weak powers in order to achieve more leverage. With regard to markets, it clearly dominates the regional economy of the wider Europe. But it strongly relies on the protection of traditional structures and producers. It neither easily gives up old industries that are no longer competitive nor is it very dynamic in developing new industries. Jobs lost to migration, import competition or relocation are to a too large extent replaced by paid leisure (early retirement, unemployment benefits) or jobs in the shadow economy rather than new employment. That trend might prevent social unrest but it further undermines state finances and capacities.

In the end, it leaves few options for stability export. The most powerful strategies like enlargement and opening Europe's markets (particularly its labour market) will be neither politically acceptable nor economically beneficial under current circumstances. That leaves the option that actors in the neighbouring countries will produce stability on their own supported by soft European incentives. But why should those in power there be less conservative than the voting majorities in the EU? In the short to medium term, they might benefit from the lack of reforms rather than from a transition to a democratic market economy (Hellman 1998; Walder 2003). Actively undermining their power will be diplomatically difficult and could produce even more instability, at least in the short term. The weak hegemon will be limited to its weak soft powers of persuasion, dialogue, and small carrots and even smaller sticks. The resulting slow and gradual change might not share the glory of revolutions Americans prefer, but might be sufficient as long as bigger threats do not enforce a radical reordering of priorities.

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