President Ilves at the 39th St. Gallen Symposium on economics and politics: “20 Years after the Fall of the Berlin Wall – New Challenges Facing Europe” Today is 9 May, Europe Day. And so, my talk is about the EU, which may not be what interests you if you are from the US or Asia, but even here in Switzerland, an island surrounded by 27 EU member states with 500 million EU citizens, and a number of countries from Iceland to Turkey clamouring to join, it is the biggest game on the continent and the largest economy on the planet.

Twenty years ago, within the space of two years, the entire conception of life in Post-War Europe collapsed. Those of us forty and older today grew up with an understanding of the world that was Manichean, bipolar, firmly ideological and militarised. Security ultimately rested on a theoretical construct, the appropriately named MAD, or Mutually Assured Destruction, the idea that we would not go to war since it would mean the death of us all.

And then, in a brief span from the autumn of 1989 to the winter of 1991, it all changed. The edifice of Soviet totalitarianism and its Eastern European glacis collapsed like a house of cards. A simple decision, to take down the barbed wire between Hungary and Austria, led to a haemorrhaging of the DDR, followed by the collapse of Czechoslovakia. At the same time we saw a democratically elected government in Poland, a revolution in Romania and the spread of the demand for democracy to the Soviet Union. Two years later the Baltic States’ independence was restored, and the Yugoslav federation and the Soviet Union were no more.

This was a fundamental re-ordering of the European and the world order, no less significant than the changes after 1918 and the collapse of Empires or, in retrospect, the forcible imposition of the untenable edifice of half a century of totalitarian control in the Eastern half of Europe. It was, moreover, a re-ordering that, unlike the end of World War II, was fundamentally a major change for the better. Yes, we had some complaining about East Germans moving to the West and the costs to Western countries in the nineties were in some cases far larger than envisioned. But in exchange, defence expenditures decreased dramatically; the overwhelming fear and anxiety about security in the Cold War era evaporated. And obviously vast opportunities opened up for business in the East. Western businesses from banks to water companies, food, clothing, consumer goods and automobile manufacturers suddenly found themselves with vast new markets. Fundamentally the collapse of communist totalitarian rule in the Eastern part of our continent was an opportunity for all.

MAD has disappeared. Our security fears are focussed on non-state actors blowing themselves and us up and potentially catastrophic cyber-attacks; the armed camp that was Western and Eastern Europe was replaced first by customs and passport controls and in this decade even those were eliminated as eight countries of the former Warsaw Pact acceded first to the EU and then to the Schengen zone.

It is important to keep all this in mind when we wallow in the doomsday predictions of today concerning the financial crisis, where we read daily in the opinion pages of our newspapers of the End of Life as We Know It, or the End of Capitalism, all written out in capital letters. The predicted GDP decline in Europe of 4% this year or even the more extreme 10-14 % predicted decline in selected countries in Eastern and Western Europe takes us back not to a primitive Palaeolithic life of hunting and gathering or even a chaotic, populist and authoritarian Europe of the 1930s but in reality to where our economies were some five years ago, when the European Union went through its fourth and heretofore largest expansion.

Let us, therefore, keep things in perspective. Yes, we probably will see a long-term shift in regulation of the financial markets and it will be a climb to restore lost value. Does this amount to a re-ordering of the world? I don’t think so.

Taking all this into account, I remain nonetheless concerned. Forgetting how much has been accomplished, having become used to the complete and utter re-ordering of our world, we take the resultant well being of the past two decades largely for granted. Peace and growth all became normal. Not only have we forgotten what “normal” meant in Europe from the 1940s through the 1980s, we now instead point the finger of blame for our current malaise at the Eastern Europeans. Instead of thinking of how much richer so-called old Europe is today because of the massive expansion of markets in the East, the huge amount of job creation in Western Europe thanks to those markets, we hear calls to shut down Western automobile plants in Eastern European countries because they take away “our jobs”. We read that “toxic assets” in Eastern Europe are a problem for “our banks”.

We don’t too often contemplate, however, why those automobile plants were built in Eastern Europe in the first place: to sell more of “our” cars there. We don’t read too often statistics for example that Swedbank, which put only ten percent of its investment in the Baltic countries, made 25% of its profits there. In other words, we overlook how much of the well being of the past twenty years depended on the virtually instantaneous creation of a new market for “old Europe” of some 100 million consumers in the “new Europe” of the new members of the European Union.

This also behoves us to look more broadly at the expansion of the past twenty years. Yes, some expansion was due to the loosening of financial regulation, the creation of unfathomable “products” such as derivatives, etc. But let us be honest with ourselves as well, the dramatic change in the wealth of Europe since 1989 was driven by new markets in the Eastern half of the EU, combined with the cheap production possibilities offered by China.

The crisis, nonetheless, has affected Eastern Europe disproportionately. And yes, lending to Eastern Europe did exceed reasonable limits, even if we do point out who made disproportionate profits in Swedish kronor, euros and Swiss francs. Even here, however, we need to be more precise. Eastern Europe, let alone the Baltic countries, is not a single country. There is no country called Eastern Europe, there is no Baltic State, Hauptstadt Riga. Each country has followed its own fiscal policy, each has responded differently. My own country, despite a decade of domestic criticism, has for ten years built up reserves amounting to 10% of GDP. Which puts us in an altogether different position than any number of countries that did not.

Some countries have run up huge amounts of state debt; other governments, like Estonia’s have borrowed virtually nothing. Some countries have floating currencies, others have fixed exchange rates. Some have had to appeal for IMF relief, others have not. Some, like Estonia, have made meeting the Maastricht criteria a political priority, with all the attendant additional requirements for fiscal responsibility. Others have not.

In other words, if we are to look at the economic crisis in Europe, let us not fall into the mindset of pre-1989, where we ignorantly speak of a bloc, not about ten very different countries, with very different fiscal policies and very different issues.

But the main point in my talk is not that the quarter of the EU comprised of new members has problems. It does. My main point is that even the downturn, recession, crisis, whatever we choose to call it, is ultimately something that will pass, but that more fundamental issues in the Union in fact have the potential to be more threatening. And we can and must address these fundamental issues, crisis or no crisis.

If we step back for a moment and look at what it is that the European Union today in fact can do, it is to begin to face those most serious issues that would exist even without the economic downturn, and which will remain with us, should the current crisis end quickly, in a v-curve or even if we face a long, 1990s Japanese-style recovery.

The three issues that I believe we have most to worry about today in the EU concern Energy Security for the Union; corruption, specifically the temptation of corruption for the political elite by authoritarian petro-states; and finally protectionism or alternatively, the inability to fully implement the four freedoms and the rule of law.

All of these are in fact related.

First, energy security. This is an issue, too often clouded by discussion of technical details of pipeline routes then followed by a leap to broad generalisations that ignore major facts on the ground. Alas it is a canard to say that energy supply to Europe from Russia has always been reliable and that the Ukrainian cut-off in January was a one-off event that was adequately dealt with in a technical rerouting of supplies. The Ukrainian gas cut-off this winter not only was a repeat of the Ukrainian cut-off of gas following democratic elections in the winter of 2005-2006, but was simply one more in a line of upwards of 30 politically motivated cut-offs of energy in the past twenty years. Estonia, Latvia and Lithuania have all faced energy cut-offs following political, or even strictly commercial privatisation decisions not appreciated in Moscow. The closure of the Druzhba oil pipeline to Lithuania followed upon that country’s decision to privatise an oil refinery to a western company. When the Czech Republic’s politics did not follow what Moscow wanted, its oil pipeline was shut down. In other words, energy not only is not fungible, it is not even strictly commercial – it is a political tool. If we do not admit that it is a tool and that it is explicitly used as a tool of foreign policy, we shall have lots and lots of problems in Europe.

I would disagree with the idea that we enjoy energy interdependence. Too many times we have witnessed economically unsound decisions guided by political considerations. It simply doesn’t wash.

Paradoxically, the end of the Cold War made us less secure in this regard. We hear as a mantra how for 40 years Russia has been a reliable source of natural gas. Indeed, during the ideological standoff of the Cold War, we did have genuine interdependence, independent of ideology. One side had the cash, the other side the gas and it was understood that other matters would not disturb the commercial relationship, be they the placement of SS-20 missiles or anything else. Only in the past 20 years has energy become a tool of policy where the tap is turned on or off based on political, not economic, reasons. This is not an analytic conclusion: if you read the Policy concept paper on the Russian Foreign Ministry webpage you will read that the government itself considers energy resources a political tool.

Thus it is important that we not be lulled when we hear businessmen say it is only business. For the business community, it clearly is. But for Europe, for the Union and its citizens, energy, its use as a tool is a threat to independent decision-making in democratic societies.

More than policy, the collapse of an ideological standoff has led to behaviours that never would have been tolerated in the Cold War. Who in 1980 would have conceived of a former head of government going to work for a foreign state-run gas company, with which he had made a commercial deal while in office? A company controlled by a government that repeatedly uses its control of the state enterprise for political ends?

Thus, the issue we must think about is not simply a matter of energy independence or energy interdependence; it is one of political independence. If you can manipulate policy-making in Europe either through fear of energy cut-offs or through post-election golden parachutes for those in government, our fundamental values of democratic choice and rule of law are undermined in ways they never were during the Cold War. Political choice not determined by the will of the electorate but by someone elsewhere and in not transparent ways is nothing new in the world. But it is not the way of 21st century Europe.

This is a broader issue we need to come to terms with. Joe Stanislaw yesterday mentioned the case of an African country awarding a contract to an Asian country after it gave a large foreign aid package to the African government. Joe asked, “How do we compete in that kind of situation?” The answer is we don’t. When authoritarian regimes shed ideology and use money to achieve their ends, when cash-flush authoritarian petro-states can use either their energy supply or their disposable income to manipulate policymakers in democratic societies or to beat out our companies through not transparent means, the democratic West will be at a competitive disadvantage of far greater proportion and longer lasting consequences than the current recession.

In this situation, where a fundamental competitive advantage of the European Union – its ability to speak as an economic bloc of half a billion relatively well off people – we see instead an atomisation, a turning away toward economic nationalism. The EU, which has been such a success thanks to the opening of the internal market, faces strong pressures to move in the opposite direction, to protectionism. Not only is this economically shortsighted, but also leads itself to a political weakening of the Union, not to mention individual member states. What has made the Union a force to be reckoned with is its ability to act as a whole; conversely, when the members look to make individual deals, with whomever, and for national gain at the expense of other members, the long-term losers are all members.

Here I would raise two areas: one, again energy, the other the four freedoms, where putting individual member state interests over the broader interest of the EU leads to a long-term weakening of all of our economic and political well-being. The EU Commission has twice fined the US company Microsoft, each time a billion euros for anti-trust violations, or in EU language, competition policy. The charge was “bundling”, automatically including the Microsoft Explorer Web browser on Windows. That is, if you bought the Windows operating system, you automatically got Explorer.

Now, as we know, we still have a choice: if we buy Windows, we can use Firefox or Mozilla. Or we can use a completely different operative system like Linux or as in my case a Mac with its own OS. But we have a choice.

Yet the commission thinks that is not enough. But when we come to energy, the member states have up till now blocked the application of this same competition policy, with far greater consequences, and where the violations are in fact far more egregious. There is no clearer case of bundling than energy suppliers owning distribution networks. In energy there is no choice: you the consumer can get your gas only from one distribution network. There is no alternative. If the company supplying your energy owns that distribution network, you have no choice whatsoever. There is no Firefox, there is no Mac OS you can switch to. Yet here, for some reason, we see EU governments unwilling to apply their own laws. I think this is fundamentally dangerous. As selective application of the law always is.

Which brings me to the larger issue of the four freedoms in the EU. We have complete freedom of movement of goods and capital; almost complete freedom of movement of people and very limited freedom of movement of services. The problem is that complete freedom of movement of capital without complete freedom of movement of services results in a profound distortion of the internal market. When the Services Directive was passed in a highly watered down version in the European Parliament, one type of service that was knocked out of the bill was free movement of water services, whatever that might mean. Yet at the same time much of the water services in new member states have been bought using free movement of capital, by old member states with the capital to do so. This is repeated over in over in the restrictions on free movement of services.

Restrictions on the free movement of services in the EU not only lead to market distortions but in restricting competition keep the EU from keeping up with the rest of the world. We worry about our competitiveness. We even passed a ten-year programme called the Lisbon Strategy to catch up with and surpass the US and Asia in innovation. But where are we? Six years ago when I moved to a different apartment in Tallinn, Estonia, I called my Internet service provider to get a new connection. The ISP asked what time would be convenient to come around. I was offered three different times that same afternoon. In 2005 when I moved to Brussels and I applied for an Internet connection, I did not even receive a reply for seven weeks. I called my landlord who had said that if there were bureaucratic problems I could ask her for help. When I told her of my difficulties, she said, “but it’s only been seven weeks!”

I submit that with lack of competition, lack of an internal market in services, when services comprise upwards of 70% of modern economies, that the EU will not maintain its competitive edge, it cannot claim the economic leverage of a half-a-billion-member economic entity. We will not catch up with, let alone surpass either the US or Asia. Indeed we will fall further behind because protectionism and individual national interests, beggaring our neighbours or simply trying to get a better deal prevents us from genuinely competing with the rest of the world.

In conclusion, none of these problems I have enumerated are about the recession. These are fundamental and systemic issues that touch upon the core principles of the EU: democratic choice, transparency, free markets, rule of law. Whether we have -4, 0, 2 or 7 percent growth, the EU will fail if it fails to stick to its principles. If political choices are not made in the ballot box but by fear of energy cut-offs or by the promise of riches after leaving office, if the market does not work because we do not apply our own laws or if we apply our principles selectively, the European Union will not work.

Oddly enough, twenty years after the collapse of the totalitarian regimes in the East, it is the new members who feel this the most. Perhaps because we remember better what it was like without rule of law, without democracy, where might made right and where decisions had no transparency and markets were most definitely not free.

For whatever reason, we need to realise, and this ultimately is my point, that backing away from what made the EU a success, for whatever rationale offered by the financial and economic crisis, will mean that when the crisis is over, it is the EU that comes out weaker than the rest. It is up to us to not let that happen.

Happy Europe Day.