



SUMMARY OF THE FOURTH MEETING

26/27 June 1998

at Spencer House, 27 St. James's Place, London S.W.1.

The Foreign Secretary, Robin Cook, welcomed participants. He saw the British EU Presidency as one of the highlights of his political career, rich and rewarding - though his heart was not now heavy with regret at passing responsibility on to the Austrians. This was clearly a time of transition but the point was, as Henry Kissinger had asked on another occasion, transition to what? The most radical challenge for the EU was the next enlargement, which would be the largest ever, at last putting the division of Europe behind us. The focus had so far been too much on the price and the pain of enlargement. He hoped the Club of Three discussion would sufficiently stress how the new members would make Europe both larger and stronger. Enlargement was in our own interest and it was necessary for the public debate to reflect this.

The main question at the end of the UK Presidency was how European institutions could be made more popular, accountable and legitimate. Decisions must be brought as close as possible to the people, as had been discussed at Cardiff. The Eurosceptics were used to hiding under the security blanket of sovereignty. Popular legitimacy was related to identity: people in his own constituency were as comfortable with being Scottish as being British, and the task was to make them equally comfortable with their European identity. The idea of Europe should connect with the democratic institutions with which people did identify, which were national. Europe must do what Europe did best in a world where states were interdependent, not independent.

Those who took a stand against this interdependence all too easily fell into national chauvinism or xenophobia. This foreshadowed what would be the fault lines of politics in the twenty-first century, which would not be a conflict between left and right, but a polarisation between an outward-looking cosmopolitanism and an old-fashioned nationalism. We must not revert to the Serb option of retreating into our national identity, but we should create a Europe which was democratic and accountable, and addressed the areas of real concern to people.

In answer to questions, Mr Cook stressed this need to make the EU a democratic project. People wanted to feel they had some hold on economic forces which could not be controlled at national level. There were also environmental questions and issues of international crime which needed to be gripped at European level. Rather than trying to implant democratic accountability in Brussels, for instance through the European Parliament, it made more sense to ensure that each level of our own institutions had a European dimension.

On EMU, Mr Cook underlined the importance of the Chancellor's economic criteria for entry. This boiled down to saying that the government needed to be sure when the timing was right. This was likely to be after the next election. But it would not be a decision for government alone: assuming the stability that would follow a successful launch of the Euro, the choice would also be for companies and individuals, as accounts were increasingly rendered in Euros. Politicians would not be taking the decision alone.

On Cyprus, there was a better prospect of resolving the problem with the Greeks within the EU family. They and the Turks would probably have inflicted more damage on each other if both had been outside. There were many aspects to the EU's relationship with Turkey and there had to be a continuing political dialogue. It made most sense to resolve Cyprus's intercommunal problem in tandem with the process of European integration.

SESSION ONE: Economic and Monetary Union, chaired by Eberhard von Koerber

Jean-Claude Trichet said it was only five years since French speakers on EMU in the US were addressing empty lecture-halls, and just a year since the Eurosceptical flavour of the media debate had faded. The Euro was now highly credible, as demonstrated by long-term rates for the franc and the D-Mark. But if the battle of credibility had been won, the war was hardly over. There must

be proper handling of the stability and growth pact through responsible fiscal management within a single monetary framework. There must be no benign neglect of the Euro. ECOFIN could impose fines if necessary: this meant the ECOFIN would have more influence over the budgets of member states than the US government or Congress have on state budgets. It was clear that if one country behaved irresponsibly this would be bad for all, and public opinion would come to realise this.

A degree of political union was inherent in EMU, and the ECB/ESCB could be described as embodying 'federalism' to that extent. There was a de facto consensus that no-one wanted a superstate.

The concern that EMU could not cope with 'asymmetric shocks' was much exaggerated. California did not benefit as much as commonly supposed from automatic fiscal transfers. The important commitment from member states would be to keep budgets balanced or as close to balance as possible: this was not ultra-orthodoxy. Over the economic cycle we must learn to reload the fiscal gun, otherwise there would be no cartridges in the tough times. The problem of structural unemployment was entirely distinct from concerns about cyclical unemployment and could only be tackled by getting at the political, social and cultural problems.

M. Trichet said he was not worried about the danger of a two-speed Europe. With 290m people, the EMU area would be broadly comparable to the 265m in the US. It would function as a big central magnet: we would soon be back to a one-speed Europe without winners and losers. With better functioning of markets in goods, services and capital, it would be a positive-sum game for all. Structural reforms were more likely to be triggered by a successful EMU. Cost pressures would lead to best practice competition in labour markets, and cross-fertilisation between them. He hoped the British would join as soon as possible. It was true that business cycles were out of sync, since continental economies had been delayed three years in hitting the bottom of the cycle because of German unification. But in a year from now, the disparity would not

look so great.

Lord Simon said the shared experience of making Stage 3 of EMU work would make the Club of Three countries more united. The decision to go ahead on 2 May had been a major turning point in the history of the EU. A successful EMU would increase the efficiency of the Single Market: Europe must be flexible and outward-looking to benefit fully from globalisation. The single currency was an enormous project, as important for those outside EMU as those within. The Big Bang had been tiny in comparison. The Euro would become the lingua franca of commercial democracy.

He regretted that the UK has been unable to join at the outset. But the UK had learnt in the course of the Presidency what could be gained from working together. EMU was not in itself the goal, rather the means to growth, employment and competitiveness. Eleven would become fifteen as long as there was a sustainable programme of reform, which was why Cardiff had produced the guidelines on structural reform, the stress on employment action plans, and the Single Market Action Plan.

Also important was the promotion of entrepreneurship and competitiveness, which would bind people together in a one-speed Europe. Only the uncompetitive would lose out. Political union was more about attitudes than institutions. The more we shared sovereignty in defence, security and foreign policy questions, the more united we would become; while in areas like welfare and health policy, the trend would be towards decentralisation. The key to being able to afford the transition was that economic reform must take root.

Rolf Breuer said the financial sector simply had to be ready for the Euro on 1 January next year. The Euro was not an end in itself but the start of an important process. European capital markets would ultimately be transformed, with government bond issues, IPOs and privatisations being denominated in Euros, in areas where European players had hitherto been unable to compete because they were not big enough. They would have more chance in Euros,

with greater price transparency, and less scope for arbitrage. As was already the trend for other goods and service markets, the Euro would let in light on the weaknesses.

EMU would not of itself enhance divergence across regions or states, nor would it of its own accord promote convergence or competitiveness. The pre-ins would not lag far behind the ins, because they would share a framework of monetary stability via the ERM Mark 2 and the convergence criteria. All EU member states were likely to join up once they got over their political problems and met the criteria in full. EMU provided a framework within which banking and finance could improve efficiency. But it was not a panacea for labour problems. It could encourage wage flexibility in Southern Europe and areas on the periphery, and thus reduce the risk premium there, which would make finance easier and promote growth. In this sense it could assist convergence.

EU enlargement was being talked up for around 2003, with everyone saying they were in favour. But it was not clear the homework was being done now. Similarly, it was very fashionable to talk about subsidiarity and the need to cut back the powers of Brussels bureaucrats. This played well in elections. But there was a huge margin for interpretation of subsidiarity. No-one could say with authority that the Euro would or could or should lead to a federal state. But there was a practical case for more powers for the European Parliament and more majority voting on taxation questions so that individual countries did not protect their tax havens. In the end, the Euro was the successor to what had been achieved so far. Everything was not sunshine and roses. The need for reform was critical. But the Euro could be a stimulant to the reform process.

Following are some of the points which emerged in the course of discussion:

- whereas at previous meetings of the Club of Three the psychological as well as economic cycles had seemed to be out of sync, all three were optimistic now. The Euro was already having an effect, in the way currency

stability had protected Europe from the ructions in the wider world.

- the silence on political union was not healthy: the Chirac/Kohl letter was only a modest step towards starting the debate, which could not be ducked for long.

- political union was not an abstraction. We would quickly learn that EMU had deep political consequences, in the way that, for instance, strikes in France would affect economic prospects in Germany. Our self-awareness would be changed in a revolutionary way.

- in some ways it was already happening: the German debate about the 35-hour week came from France. People constantly underestimated the degree of political union inherent in a European Council voting by qualified majority. If harnessed properly this might one day lead to Europe being humiliated somewhat less in the Balkans.

- there should be greater rigour in judging which decisions needed to be taken at European level; and more focus on which decisions at European level really required political decision from national governments. We do not take this aspect of the institutional process seriously enough.

- concern was expressed at EU levels of debt which were higher than those in US states and more worrying: Italy was 15% of EU GDP against California's 5% of the US. The trouble with the stability pact was that it let governments off the hook of market discipline. The good years had to be used to bring debt down in time for the bad years: otherwise we might all be paying the price for an Italian recession in three years' time.

DINNER

Peter Mandelson made an informal after-dinner speech in which he applauded

the work of the Club of Three, stressing that the Club would not be an exclusive Gang of Three. It should be ecumenical. There was a long way to go for the UK, much to change, but the British government hoped in the course of the next ten years to play a role in Europe as significant as that of France or Germany. There were still swathes of people to be converted to the idea of a positive role in Europe, not to mention a few newspaper proprietors. This more positive role could not happen fully with Britain outside the Single Currency.

There had not since Edward Heath been as pro-European a Prime Minister as Tony Blair. But this government was not just for Europe, but for a reformed Europe. This meant striving for the completion of the Single Market, assuring a successful start to EMU (where maybe two ECB Presidents could be better than one), pressing economic reform and encouraging enlargement. Some areas of European activity did not require further integration. But further sharing of sovereignty would make sense on CFSP and Justice and Home Affairs questions.

There was however a growing unease that the popular foundations of the European project were looking insecure: this perception was not limited to British Eurosceptics, but reflected a wider feeling that Brussels was interfering and remote. The need was for more, not less democratic legitimacy. There was now a need for new thinking beyond the clichés. We should draw more on national parliaments, beef up subsidiarity, and increase the oversight of the European Council on day-to-day Community activity. Perhaps there should be a direct link between Europe Ministers and Heads of Government. Maybe the time had come to look at a second Chamber of National Parliamentarians. Subsidiarity was a political rather than a legal concept: what should or should not be done by the EU should be judged in that light. Health, welfare and education, for instance, were for national governments.

Broadly, the European social model was there to be reformed and not abandoned. Britain might be ahead of the mainstream in many questions but was not outside it: the past six months had been the most successful period

ever for progress on Justice and Home Affairs. There were good action plans on drugs and organised crime. The UK had opened up the debate on legitimacy and now new commitments would be required: Britain would do its bit at the October Heads of Government meeting in Vienna. The Three should concert positions in advance, which would be better than a Franco-German dialogue leading to a Franco-German 'bounce'. Prime Ministers should be involved in these exchanges.

The British would not seek to intrude on the complex, wise and wonderful relationship between France and Germany. But there was now much common ground between them and the British, especially on economic issues. There had been a change in the stance and attitude of Prime Minister over the past year: the UK and France were not as far apart as some commentators maintained.

There would of course be differences, over tax and social policy, over security and defence. This had been the case over Iraq. Tony Blair was strongly Atlanticist, but in a way entirely different from Mrs Thatcher. He knew that the stronger Britain's relationship with Europe was, the more it would bring to the relationship with the US. The British government had an open mind on the future of defence policy, on which Amsterdam had not been the last word. We should not limit ourselves to re-iterating that nothing should be done that could jeopardise NATO...

It was true that the Kohl/Chirac letter on a People's Europe and subsidiarity, before the Cardiff Summit, might have come from Tony Blair himself. His reaction had been mature and positive: Britain now had the confidence not only to advance our own ideas but also to work with the aims and values of others. We knew we could not do it all alone. To that extent we were learning not to insist on being team captain all the time. But we would be good team players.

Peter Hartmann welcomed Peter Mandelson's comments and recalled how the

Cold War had concentrated minds and produced joint efforts on a grand scale. As we celebrated the fiftieth anniversary of the Berlin airlift it was timely to recall the saying that it was better to be blockaded by the East and fed by the West than vice-versa.

The themes of our times were competition and co-operation, with the EU increasingly the key instrument of national interest and influence. There were no fundamental differences between the Three, as we saw from day-to-day trilateralism, for instance in the Contact Group. The relationship with the US was developing well, beyond the old clichés and prejudices: it was clear that more NATO for all today would mean more Europe tomorrow. He was confident that the UK would be welcomed into the Euro-Club before long.

Philippe Berend said he was not a fan of the oft-repeated line that EMU would kick-start France into the reforms it needed. What was going on was more subtle than that. Reform was happening and going to happen further whether we liked it or not. The traditional divides between left wing and right wing policies were no longer as clear as they used to be. The differences between Anglo-Saxon and Continental models were much more subtle. Furthermore how our 3 countries adjusted to the ever greater integration of Europe depended on which Europe we were talking about, since the Europe of EMU has 11 member states, the Europe of Schengen 12, the Europe of Defence or football many more. Each of them affected countries differently, such as the Bosman ruling for football players or the French Loi Sapin for anti-competitive practice. In both cases, Europe could be used to circumvent national laws and patterns and thus blur differences between countries.

Even though many national traditions were in decline, nationality or nationhood - with its symbols - still mattered. The Reinheitsgebot on beer reflected this in Germany, as did similar concerns about cheeses in France. But in other areas, like telecoms, nationality was no longer relevant. We were seeing the end of national monopolies. Just as there were many different European structures and geometries covering various areas of European life, corporate life was

marked by the advent of similar ad-hocism: for instance, ABB worked, Airbus worked, the Club of Three worked. They were not characterised by any iron laws. But they were each somehow right for a flexible, changing, infinitely varied world where traditional structures were becoming irrelevant.

SESSION TWO: chaired by Charles de Croisset

Anthony Giddens explained his understanding of the Third Way which was identified with the rise of Tony Blair and New Labour. The significance of the debate went well beyond the UK. It was about going beyond the failed philosophies of old-style social democracy and neo-liberalism. Thatcherism had been significant for its anti-elitist, anti-establishment way of giving play to market forces. But society could not be run as a market-place. The Third Way was about harnessing the market in the cause of social solidarity, taking account of technical trends, international competition and the need for social justice.

In working out the relation between competitiveness and the social dimension, the US example was instructive: there seemed at first sight to be a trade-off between dynamism and equality. But these features in the US were not replicated in the welfare societies of Europe, especially in the way the usual US model of labour mobility did not appear to relate to unemployment levels. The strong variations suggested that strict unemployment legislation did not promote lower unemployment - though there was some effect on total employment - and it could be that benefits and education levels were more relevant. It did seem clear that a minimalist welfare net was not the best way of reducing unemployment.

While it was true that there was something of a crisis in funding pensions, this did not mean there was a broader financial crisis in financing welfare. New ways had to be found to incorporate risk management, as a token of individual autonomy, into our welfare systems. The literature of private insurance was

written in an entirely different way from the literature of welfare, but we should realise that there was actually an element of moral hazard in all insurance systems. Imagination was now necessary to encourage active risk mechanisms which would reflect a new balance of risk against personal security throughout society. For instance, the institution of marriage had previously had a stabilising effect in the lives of individuals and of society at large. Now that people tended to have more than one such relationship in the course of their lives, individuals should take on some of the risks and take responsibility for managing the transitions. This was similar to developments in the labour market.

Unpacking the notion of risk would be difficult: business theory made risk a mobilising dynamic, through hedge funds and derivatives, while statist thinking aimed to minimise risk, whether from an ecological, health or welfare point of view. The essential point was that risk implied responsibility. Achieving a new balance between individual and collective risks and responsibility should underpin the reform of the welfare state. There was a need for a more entrepreneurial culture and a risk-taking workforce, but this was only going to work if there was a proper social framework when things went wrong.

Education, training and re-training were the mantra of today, but they would not make the difference. A learning society also had to be a forgetting society when it came to accepting risk, being mobile and surviving the transition. Mobilising risk should not involve an unacceptably high level of job destruction. Only a social Europe could be a commercially successful Europe. This would not be by the old social democratic or the Christian Democratic route. It would be by a Third Way.

Bernd Pischetsrieder reversed Professor Giddens' conclusion to say that only a commercially successful Europe could be a social Europe. Looking around either Europe or the US, there were commercially successful regions, and successful sectors - of the economy as of society. Globally, the trend was not so much for economies to be in competition with one another as for companies to compete. Even now, there were successful Asian companies just as there

were unsuccessful American and European ones. The task was to promote the circumstances which would produce success.

In Germany, this was still mistakenly understood as politicians creating jobs. But only consumers created jobs. Firms had to show creativity in terms of products and their costs. Only then did the wider social, economic and political questions come into play. But they could do a great deal in promoting productivity if they encouraged flexibility and mobility. Perceptions of social Europe were very different between Germany, the UK and France. 90% of the conditions under which motor cars were produced in Germany would be impossible in the UK, and vice-versa. BMW was deeply socialist by British standards, with its workers' councils which had existed long before the Social Charter; yet in Germany BMW was seen as conservative. There were different meanings for the same word in Britain and Bavaria. Flexibility operated at different levels, in different ways. Only a rigorously commercial sense could create shared social values; if you started with the social values, the starting points would be just too different. There was no shared European Third Way.

One challenge we all faced in common was the need to see education in terms of lifelong learning: what we know today will not be what we need to know tomorrow. Job enrichment, in the sense of combining know-how and knowledge with experience, was the task of companies as well as the state. As far as the Asian crisis was concerned, social conditions should not be held responsible: every business must be built on solid foundations, and it was clear that this solidity had not been there in either political or economic terms.

Pascal Lamy agreed on the diversity between the Three, but he saw far more in common, in particular in the way we were all striving to find the right mix of competition and security. This approach was deeply rooted in our history and culture. But there was a need for reform.

European integration was a part of this. We were competing within the EU as well as with the rest of the world. There was a problem of social dumping which must be addressed, just as there were questions of public service

provision which related to competitiveness. The problems of the single currency would have to be confronted with due attention both to its value and its external credibility. On the other hand, while there should be full awareness of these questions at EU level, implementation of programmes could be managed perfectly well by national systems. We were learning more about decentralisation and management, including the management of risk, and the approach of benchmarking within the Club of Three was a good one, with some useful lessons from the UK.

The lessons from Asia seemed to be that it might have been worse; that Europe had coped rather well with its comparative insulation; and the performance of the financial markets had been far from perfect. The risk premium for Asia had been too low. This had less to do with economics than with the sort of societies and government systems in Indonesia or Japan. Sustainable growth needed sustainable societies.

Some of the further points to emerge in discussion were as follows:

- it was suggested that the more fundamental question for Western societies was whether problems were bound to arise when state spending was closer to 50% of GDP than 25%. Looking at comparative tables of government expenditure, taxation, unemployment benefit and social security budgets, was there not a clear inverse relationship between these and economic success? There was vigorous discussion, without agreement, on this point.
- perhaps the corporatist model worked best in small countries, with strong trade unions operating within a social consensus. The Austrian and Netherlands models were suggestive in this respect. But their approaches might not be exportable, especially from the Netherlands where there was a very individual approach to disability benefit. A broad European framework, with subsidiarity in the way social systems were operated, might be the answer.
- doubt was expressed on whether the crucial local factors, to do with

motivation, job-satisfaction and stress found their way into any statistical models. Another reason for implementation to be local.

- whatever the differences, there were ways in which productivity could be measured, and BMW showed that it was possible to compare workers in Bavaria with those in the West Midlands. The latter were clearly 35% behind, 40% in some areas, lacking the training and the ability to run complicated machinery which the German workers possessed. More work should be done in identifying just why the British were not more productive. There were cultural reasons as well as those relating to skills.

- a significant trend in Britain was the retreat from both Wilson and Thatcher to Beveridge, Lloyd George and even older traditions of mutuality. These traditions were now being re-discovered. The context was not only obligation and responsibility but the wider social framework including the important concept of citizenship

- trade union traditions were evolving all around Europe, and feeding off each other: the Works Councils of ABB represented some 40,000 workers around Europe, and one trend had been for the more confrontational, Latin approach to be superseded by the more co-operative North European model. But there had also been a trend for smaller countries to hold together against the larger ones; and a sort of 'best-practice' approach had emerged which was positive.

- it was finally suggested that the significant thing about the Dutch experience was that they had found their own way out of the problems which had confronted them since the 1960s. Maybe there was not one Third Way, but several.

SESSION THREE: Enlargement, chaired by Lord Alexander

Minister-President Kurt Biedenkopf said enlargement was happening and the question was no longer whether but how. It made sense that the protective shield of NATO had first been put in place: this made the countries in question part of the Atlantic community before confirming their place in the European community. Poland, Hungary and the Czech Republic might be Slavic but they had been part of Roman Europe and of Catholic Europe. Last year's celebrations in Warsaw of the 300th anniversary of crowning a Saxon King showed the closeness of the links in this corner of Europe - as did the close co-operation between Bohemia, Saxony and the new *voivod* of Lower Silesia, which together constituted a Central European region. At the turn of the century, Saxony had been the most industrialised region in Germany, and Bohemia the most developed in Austria-Hungary. It would be a mistake to overlook the cultural affinities between these areas in reviewing the economic and political factors. There was not a purely economic rationale for EU enlargement.

It was also important to take mental factors into account in these countries, since their history under totalitarian rule did not prepare them necessarily to be open to more competitive societies. Economies which had previously to maximise employment had to learn to maximise creativity. Whereas some 90% of those employable had been employed previously in these societies, it would be realistic to expect 65-70% employment on Western trends. This meant the Eastern Lander were bound to have some 25% unemployment with the shift to a market economy; in Poland the blow had been softened by 25% of the workforce having been in an agricultural sector that was not socialised as in other bloc countries. But they too would have to cope with the general shift towards a service and industrial economy.

The Lander also had problems with the sophistication of the legal system they had imported from Bonn. The system as it existed in the 1950s would have served their needs better. It was necessary to examine which parts of the legal and political framework could be transplanted eastwards. For instance, the idea of equality was seen very differently: if you removed the *nomenclatura*, you

would find that the spread of incomes in plants in the old days was not much more than 1:3 between top and bottom. People still had difficulty understanding why one sort of service deserved significantly better remuneration than another. There was a need for more education and explanation. The concept of personal responsibility was still different.

As far as Europe was concerned, institutional complexity needed to be reduced wherever possible. The interaction between levels of jurisdiction should be re-examined as suggested in the Kohl/Chirac letter. Labour market questions should not be tackled in Brussels. There was a long-term need for labour mobility, and the question would become immediate when the Poles began their transition to EU membership. Similarly, it should be recognised that the lid on EU spending of 1.27% of GDP would mean someone was going to pay a price: the Spanish position was already on the record. We must not forget the deeper logic of enlargement expressed by Vaclav Havel, who had said that if Eastern Europe was destabilised then all of Europe was destabilised.

The Central and Eastern European countries had a bridging function: they posed fundamental questions to the EU in the same way as the Mediterranean countries asked questions about North/South integration. But we must remember that these arguments, strong as they were, did not of themselves create the political constituency to bear the financial and economic costs in EU countries. There was not the same awareness as there had been in the Cold War of how these countries constituted part of the security of the West.

François Heisbourg recalled the clear opportunities opened up by enlargement, which would open up new centres of growth, dynamism and cultural creativity for Europe. Poland could play a similar role to Spain in opening up the EU. When countries were willing to go as far and as fast as possible in anchoring themselves in the EU the results could be as heartening as with Finland, which was now, definitively, in Europe.

There were of course threats to future coherence, indeed a danger of entropy, as the EU grew bigger. It did not have one natural leader, it was genuinely multipolar, which meant there must be more integration. This in turn meant more majority voting. EMU would bring greater centralisation of significant powers. The rebalancing of powers between the centre and the member states that had been mentioned was all the more important. The danger of entropy was not the same for NATO, where the US was the natural leader: other questions then arose about the nature and quality of the US engagement. The Bosnian crisis of 1992-95 had shown the danger when the US was just not there; and the present tendency to take a somewhat unilateralist approach, without UN Security Council cover, showed the opposite danger. Managing these fluctuations was an important task.

The dilution of the EU through the Central European enlargement was in some ways less significant than the earlier enlargement to the neutrals. Most of the new applicants were absolutely sure they wanted to be part of Europe. The implications of their adhesion to NATO went further, because apart from the core security task within Europe, the mission was up for grabs. We knew we wanted to keep the US in Europe but we were not sure what other missions lay ahead.

The issue of different memberships of the EU and NATO was much exaggerated - the powerlessness in Bosnia had different, political reasons. The attempt to modernise and Europeanise NATO had failed because of differences between France and her partners. This had destroyed any chance of a European Security and Defence Identity for the time being. Amsterdam had brought not a lot of progress. Europe had achieved more under a WEU flag ten years ago in the Gulf and then the Adriatic, than it had been capable of delivering last year in Albania or this year in Cyprus. With new EU members who were already in NATO, it made sense to concentrate less on what was difficult - ESDI - and to concentrate more on what was achievable - EMU.

But Russia was a problem. Poland joining a military alliance with the US meant

NATO could never be popular in Russia. Primakov would find ways of extracting revenge: he could be moderately difficult by making trouble between Greece and Turkey, and maybe more dangerous in offering to make peace between Greece and Turkey. We for our part had mishandled the Turks, in saying they could not join the EU because they were not Christian. We had also mismanaged the Cypriots in suggesting they could join the EU if they had control of all of their territory.

The immediate financial costs of NATO enlargement had at least proved much lower than anticipated: around one tenth of the wilder suggestions up to \$120 billion. The military assimilation of the new members should not be too difficult, though working out new forms of force projection would be more costly. With reasonable economic growth and effective restructuring, the process should not be too difficult. The medium-term priorities should therefore be economic reform and making a success of the Euro. In 5-8 years' time, we might then talk seriously about ESDI and CFSP. Until then, problems like Kosovo and Cyprus would be settled not by the EU but by the Americans and other bigger powers, working in *ad hoc* formations like the Contact Group.

Sir John Kerr drew attention to the 'shallow consensus' in Europe in favour of enlargement, combining both those who wanted more integration and less integration as a result. From the British point of view there was an element of historic guilt - the dates of 1838, 1945, 1956 and 1968 all had a resonance for the political class in connection with the countries concerned. On the other hand Mrs Thatcher's famous Bruges speech had contained positive references to Warsaw, Prague and Budapest as great European cities when this was not fashionable. The present government certainly believed that enlargement would contribute to building up a healthier EU.

People in the US had only started to believe in the imminence of EMU in 1996, and they then concluded that the Europeans would lose sight of enlargement. But the EU was not President Gerald Ford: we could chew gum and ride a bicycle at the same time. The US concern that the EMU hurdle

might be set too high had been proved wrong: Greece was sitting in a waiting room - which it might not need to use anyway.

The next enlargement would add 30% to the population of the EU, and 50% to its land area; yet the total GDP of the countries in question was less than that of the Netherlands. Rethinking the EU budget would be tricky: extending the CAP on present lines would cost 10-12 billion ecus, with another 23 billion ecus on the structural funds. But the 1.27% ceiling was acquis for now: there would have to be CAP reform, an end to price support, and painful changes to the structural funds. There were complications attaching to the dossiers on borders, on law and order and on the environment - an environmental clean-up to reach EU standards in Poland would ultimately cost 30 billion ecus. There would be political problems on the Polish border with Ukraine and all the problems legal and institutional which Mr Biedenkopf had referred to. But the EU would have to 'interfere' if enlargement was to be for real.

More broadly, democratic legitimacy was important and voting weights in the Council must be brought into line with population: it was not sustainable for one vote to equate to 150,000 Luxembourgers and eight million Germans. On the other hand, greater use of QMV would be the logical quid pro quo. There also had to be a smaller Commission: the big countries would give up a commissioner each, and it would be best if they could do so in the course of a brisk IGC next year. Both political will and popular will had to be harnessed for the changes necessary: in Germany the popular will was already there and the political will should be after September; in the UK and France, political will was there but popular opinion must be rallied. It was not enough to talk positively in general terms about Europe, but to duck the specific questions raised by enlargement.

As to NATO, it would not be undermined by greater EU co-operation on defence questions, which could clearly be improved. Those who opposed NATO enlargement had seen their arguments disproved, whether they had said with George Kennan that Russia would react violently, or with Henry Kissinger

that the alliance would be devalued. The decision to go for three new entrants had been right. Estonian membership of NATO would have been a genuine threat to Russia, Polish membership was not. NATO should stay out of Ukraine and the Baltics.

Sir John was depressed by the lack of political will to consolidate Europe's defence industries, and felt there was urgent work to do on NATO's institutional structure and budgets. European countries should not feel they should accelerate unrealistically the enlargement of the EU to Rumania and Bulgaria, to compensate for the decision not to take them into NATO.

In the course of discussion, the following additional questions were raised:

- the challenge of Russia should be defined in more positive terms. Could Russia constitute a second pole in our global security? Did we not have a common vision we could share with Russia? If Russia was not a member of NATO, were they destined to be hostile?
- the relationship with Russia was about to be tested over Kosovo. Would they allow their loyalty to Milosevic to constitute a veto on international action? Most probably not.
- as the politics of the EU became part of the hard core of policy-making in member states, it was all the more important it should be seen to embody democratic legitimacy. It was doubtful whether there was as much coherence in the shared 'culture of interaction' as there had been ten or twenty years ago.
- was it time for an EU seat in the Security Council? It was observed that EU influence was likely to be maximised with an enlargement to include Germany, together with the present arrangements for permanent and rotating members. If there was no CFSP worth the name it was not very logical to have a single European seat. Perhaps the main priority for the Council right now was in any case to admit some significant non-nuclear states.

- perhaps there was a need for a task force within the EU to lead the house-cleaning necessary to do justice to the new members.

- defence consolidation was indeed a European priority. But it was bedevilled by national thinking and nationalisation. The French government had now moved a long way and the British-German pole was obviously important: what looked like emerging was better than total balkanisation, but not sufficiently thorough-going to compare with the US restructuring of their defence industry.

- we should postpone defining the outer limits of the EU: if not, our relations with both Russia and Turkey would suffer. It would be wrong to dash spirits in those countries with the idea of rejection; it also would serve our interests better to preserve a certain ambiguity about the identity of Europe, and who we are. This would be in line with an old Foreign Office maxim about it never being time to settle an issue. The Turks had been told they had a European vocation and recent developments had suggested in a damaging way that the EU was reneging on that. As to Russia, it might be a kindness to say they did not belong. But it would be a pity from our point of view.

- The Chairman concluded that the stress on political will at this and other sessions had been important and right. There was now a strong identity of view among all the members of the Club of Three. In taking the decisions which lay ahead, the political class in each country should have the courage to draw on history, and not to act on the short-term considerations which always presented themselves.