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The Northern Dimension: Interdependence, specialisation and some popular misconceptions

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Ladies and Gentlemen,

After the Northern Dimension was made official Union policy at the December 1998 European Council meeting in Vienna, we have all understood and accepted the underlying thinking. The principles of the initiative are well known and spoken in a jargon that tends to make everything nothing but plain and clear. But let us reiterate them once more, just to make sure that we have a level playing field in discussion.

Thus, we all know perfectly well that similarly to the Southern Dimension, the Northern one is a way of promoting management of the European Union's external relations. It is naturally a common policy, not a policy of the northernmost members of the Union. Further, it is a policy aiming at mutual economic dependence between the Union and such non-members as Russia. Interdependence is indeed the main premise of the Northern Dimension. Interdependence creates political stability through co-operation and sunk investments. All in all, the Northern Dimension is a policy to bring value added in such disparate fields as infrastructure (including transport and telecommunications), trade and investment, nuclear safety, energy, sustainable utilisation of natural resources, environment, cross-border co-operation, the fight against crime, human resources, health and the social sector, as well as strengthening democracy and the civil society.

And now comes the biggest promise of them all: all of this should be possible by utilising existing Union instruments and budget frameworks. Admittedly, there is a wider angle and opportunity cost considerations do arise, as the Northern Dimension is also about co-operation and co-financing between private investors, international investment institutions and public programmes. Still, ask anybody and you will hear that the Northern Dimension is absolutely not about creating jobs for bureaucrats and spending more of taxpayers' money. In short, judged by the various Union and also Finnish pronouncements, the Northern Dimension is one of those wonderful umbrella concepts that claim to offer a free lunch.

Well, at least an almost free lunch. Perhaps in the end it will be noticed that some small institutions and expenditures will be needed. But that still remains to be seen. For the time being the Northern Dimension has been an offer that nobody could possibly decline: security and stability – free of charge. And as long as the initiative has not been specified in any detail, it has also offered another huge benefit: being a shell that anybody can fulfil with almost anything. But these happy days are fast passing by.

Surely the first and perhaps the biggest misconception about the Northern Dimension is in deed the promised perspective of a free lunch. As an economist, I naturally always have to underline that there is no such thing as a free lunch. (Though surprisingly enough there actually are instances like monetary stability that come very close to being a free lunch.) But let us not pause here. I am not a participant of the detailed negotiations underway now, during the German Presidency. So I do not know what are the actual plans at this point of time. We will be informed about them at a later point of time. Perhaps somebody here will be able to clarify this point in the debate.

Often misconceptions have their mirror images. Russia was perhaps somewhat slow in being converted into a supporter of the Northern Dimension. Now that this support is much in evidence in official Russian pronouncements, one suspects that some of the Russians have wrongly concluded that the Northern Dimension is a money printing device. Surely, Russia does need a huge amount of finance. But that money primarily needs to come from domestic savings. The Northern Dimension can never solve Russia's financial problems. Hopefully, excessive expectation have been created neither in Russia or elsewhere. Judging by plentiful previous experiences, that is probably not the case. Whatever the good intentions, somebody always gets them wrong. Most often, fortunately, the mistaken interpretations are not of any great consequence.

Talking about money is rarely boring and almost never unfit for gentlemen. Still, let us rather make our first stop proper at what is dubbed the main premise of the Northern Dimension, the idea that interdependence creates political stability. This is certainly not a novel idea. It is frequently argued in international relations literature that the mutual benefits which accompany interdependence discourage conflict between states. As these benefits increase, so do the opportunity costs of severing ties through conflict. There is one claim in international relations literature that seems to enjoy overwhelming support: democracies do not fight one another. The claim more relevant to the Northern Dimension —interdependence breeds peace – is almost as popular.

Having admitted that much, one has to add that there is at least a potential misconception here as well. The problem with interdependence as a tool in discussing international relations is that it is a complex term. It should be argued at least in economic, institutional and cultural terms. There are economic ties that bind, but shared norms and rules or shared memberships in alliances may in the end be more important. All too often the discussion on interdependence is only in economic terms, and even economic interdependence is frequently measured very narrowly, by trade flows only. We know that Russia is highly dependent on European markets both in terms of supply of exportables and demand of import goods. The Union has a trade share of almost 40 per cent in Russia, and Russia has become a trade-dependent country. With further Union enlargement, its share in Russian trade will further increase, and it would be difficult to roll back Russia's foreign economic openness.

Still the future always offers a set of alternatives. Economically, Russia is today at crossroads that have appeared in the similarities and dissimilarities in the economic policies of the Kirienko and Primakov governments. Russia might – as seemed to be the Kirienko premise — allow a more or less equilibrium exchange rate and undergo de-industrialisation for lack of competitive production. In that case the country will be dependent both on imports of technologies and consumables and on export of energy and raw materials to pay for the import bill. The role of commodities in Russian exports has increased further. De-industrialisation is almost irrelevant to that, as few would expect Russia to be under any scenario able to develop new industrial export goods in a scale that would be macroeconomically decisive. Whatever policies are chosen, Russia will remain primarily a commodity exporter. That is basically a matter of gas. Gas flows in pipelines. They go to Europe. That is where the demand for energy and the money to build pipelines is. Now and in the future.

The difference between policy options is sooner on the import side. The alternative to accepting de-industrialisation – and this seems to be the Primakov government approach – is to try and maintain an undervalued exchange rate. This will act as an import barrier allowing domestic industries to supply home markets with manufactured goods and foodstuffs that are

not really exportable because of quality differences. This seems to be the base for the current upturn in Russian output statistics. On the other hand, many commodity exports are booming, also creating revenue that should in principle be taxable. But the maintenance of undervaluation demands the ability to keep real wages very low, and various measures to control trade and financial flows may also be needed.

This is certainly not the place to go into the economics of undervaluation and dual development, though there is rich experience concerning India and other countries. One should just notice that the implications for trade interdependence depend on the path to be chosen by Russia. In any case, Russia is and always will be hugely more dependent on Europe than vice versa. The argument on European trade dependence on Russia can not be made in terms of aggregate statistics – not even in the case of Finland. Instead, it is usually based on expected needs for energy and gas in particular. This argument clearly has a sound base and the figures usually cited sound supremely convincing. But we know enough about energy demand and supply projections to be quite careful before jumping into conclusions in terms of financial conditions, space and time.

Thus, the future forms of interdependence pose one choice for Russia. There is another crossroad for Russia as well, that of diverging interpretations of interdependence. For economists interdependence is another name for division of labour, that great machine producing the wealth of nations. For many theorists and practitioners of international relations, the cultural externalities of interdependence create a sense of community within which problems are solved peacefully. But another interpretation also exists, and it has strong roots in Russian thinking. Many Russians stress the strategic or economic vulnerability which can accompany mutual but especially asymmetric dependence. The issue of economic security has been much emphasised in Russia recently. And naturally, there is the anti-Smithian – or in Russia the Leninist — background that helps to argue that dependence is actually a front for exploitation of Russia by the West. Interdependence – and even much more so unilateral dependence – in this view fosters structural violence and conflict. This is not merely an ideological viewpoint. It also has much empirical support in history.

In Europe, this is the reason why we always underline that Russia must be an actor, a subject, not an object of the Northern Dimension. Are our assurances taken seriously? Plainly, that depends on how we are seen. In Beijing, one easily hears especially analysts of the older generation arguing in the Leninist vein that the West set upon destroying Russia and has succeeded in doing that. In Russia, the same feeling is echoed even by people regarded as belonging to the democrats. The economic reduction of interdependence into gas flows does not help the matter. Neither, for that matter, does the current conflict in Kosovo. The overwhelming Russian reaction is not an issue of Slav brotherhood or the orthodox belief. It is an issue of perceiving the United States – not so much Europe – to have practised naked hegemony once too often.

One has to admit that the structure of trade relations between Russia and Europe is such that arguments of unilateral dependence and imperialism will have a fertile ground, whichever is the economic road chosen by Russia. Current ideological and foreign policy developments will tend to strengthen the hand of those worrying about asymmetric dependence in Russia. In the West, on the other hand, the voice has become much stronger that Russians should be left to broil in their crises until they learn – though it is usually very unclear what exactly they should learn. What to do?

Fortunately, interdependence is not only about economic ties, it is also about culture and institutions. These days, it is rather less than perfectly fashionable to talk about Europe from the Atlantic to the Russian Far East. Still, there is probably more cultural interdependence

between Russia and Europe than we now often tend to remember. This, at least, is the message of the recent monograph by Martin Malia, a major authority on Russian history. When the pendulum swings too far into one direction, it is often the historians that remind us of the proper balance.

In this light, the recent initiatives to maintain something resembling a free press in Russia are very much welcomed. So are the programmes to further modern economics and other social sciences in Russia. They all further cultural interdependence. Strangely, many of the more interesting initiatives in these fields come from across the Atlantic rather than from Europe.

Institutional interdependence is much more difficult to enhance now. Clubs have their rules, and Russia does not seem intent to fulfilling those of many clubs in a foreseeable future. The old wisdom remains valid: if doors have to be closed, let the Russians do it. We can leave the doors open.

Ladies and gentlemen,

You will have noticed that my speech has been an example of one particularly popular misconception about the Northern Dimension. I have spoken as if the Northern Dimension were identical with the Union's Russia-policies. Russia is crucial in the Northern Dimension. The Northern Dimension is about integrating Russia with Europe. But Russia is not all that matters. Not geographically. Until all the Baltic countries become Union members, the Northern Dimension will also be about them. Poland, Iceland and Norway are also directly involved, in particular because of the importance of cross-border issues in the Baltic and Barents Sea areas. Britain, The United States, Canada and perhaps other countries as well are involved. Perhaps more importantly, the Northern Dimension is not so much about particular countries. It is – in my view at least – much more about interdependencies, links and regional structures.

The relation between Russia and the three Baltic countries is a crucial example here. Here we have a shining example of true interdependence. Some forty per cent of Russia's exports goes through the Baltic harbours, which are today doing more transit business than ever before – and profitably. This business generates a major amount of national income for these countries. The ongoing Russian economic crisis has highlighted another facet of this interdependence. Though you would not be able to see it from the statistics, probably between one third to one half of the foreign trade of these states is with Russia, Belarus and Ukraine. Decline in Russian imports has cut into the growth prospects of the Balts, and vocal opinion calls for less trade with Russia.

In the Baltic area, both partners have problems in accepting the facts of interdependence. The dependence on harbours in another country's territory is sometimes called – for very obvious reasons – the Rotterdam syndrome. Many of the Russians have difficulties in accepting that this is not a terminal illness but a way of utilising existing resources. Therefore, they have planned for any number of new harbours in the Eastern end of the Gulf of Finland. Fortunately, they do not have the money to build them. This is fortunate, as the duplication of existing facilities would be a waste of resources.

Many of the Balts, on the other hand, have especially after the open economic crisis erupted called for a further economic and perhaps also economic distancing of their countries away from Russia. Two comments are in place. The speed and extent of redirection and indeed creation of foreign economic ties in these countries has been extraordinary, and it

marks a major success story. On the other hand, one again has to underline the need to utilise existing resources. The geographical location and existing infrastructure of these countries are among the resources to be utilised.

Ladies and gentlemen,

A number of possible and actual misconceptions concerning the Northern Dimension still remain to be discussed, but they must be left for another occasion. Let me just leave you one final thought, possibly a sobering one.

As you will have heard, the welfare gap on the Eastern border of Finland is one of the deepest in the world. The salary of a Finnish nurse or teacher is some fifty times higher than that of an eastern colleague. The probability is very high that the overall welfare gap dividing Europe will grow even larger in the decades to come. We intend to grow by some three per cent annually, while growth in the Baltics and other parts of the new Central Europe will probably be clearly faster. Russia, in my view, will grow slower. Why that is so is too long a story to be recounted now, but it is basically about the need for investment-based growth in Russia and about the inability of the Russian non-monetary exchange economy to generate the savings necessary for financing those investments. Furthermore, it might well be that any growth that Russia will reach will be geographically concentrated primarily in the resource-rich regions further away from Russia's western borders.

If that were indeed so, we should be vitally interested in a Russian state that has a centre strong enough to be able and willing to tax part of the export revenue of commodity exporters. Part of that revenue should be used in a regional redistribution scale to prevent the welfare disparities within the country – and across borders – from becoming a huge social and political risk. Therefore, though the Northern Dimension has a Russian regional aspect to it, we are not interested in a political dissolution of the country. On the contrary.

In selling the idea of the Northern Dimension, much emphasis has duly been put on the possibilities that Russia's famous potentials offer. One can never emphasise too much that it is up to the Russians themselves to create the ability to maintain, improve and utilise those potentials. Here the role of the international community can never be much more than marginal. But we simply must try and make any difference that we might be able to make. There is a probability – perhaps even a major one — that Russia will fail to generate the welfare and stability that it so badly needs and deserves. Then, the Northern Dimension would become a vehicle of crisis alleviation. That is not necessarily a pleasant possibility. But if the European Union were unable to address the risks and challenges posed by the various ways that Russia's development may take, our conclusion can only be one: Common Foreign and Security Policies always were a remained a chimera. Such is the relation between Russia and Europe, the innermost contents of the Northern Dimension.

Notes

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