

Canadian NATO  
Parliamentary Association



Association parlementaire  
canadienne de l'OTAN

**Report of the Canadian Parliamentary Delegation  
to the Visit of the Economics and Security Committee  
Sub-Committee on Transatlantic Economic Relations  
Canadian NATO Parliamentary Association (NATO PA)  
London, United Kingdom  
April 23-25, 2008**

# Report

The Canadian NATO Parliamentary Association has the honour to present its report on the Visit to London, UK by the Sub-committee on Transatlantic Economic Relations, April 23-25, 2008. Committee members consulted with government officials, policy experts and academics on a range of topics including the Russian economy, the situation in Afghanistan, India and the global financial crisis. Canada was represented by Mr. Leon Benoit, M.P. and Mr. Roy Cullen, M.P.

## **RUSSIA**

The meetings opened at the School of Slavonic and East European Studies with a set of briefings on the Russian economy. Russia has undergone a genuine economic boom over the past decade. Rising energy prices have been the key driver of economic growth as well as a consumption boom which has spawned a surge in imports. This growth has allowed Russia to clear up wage and pension arrears, and the economy is now fully monetized. There are also signs that parts of the private sector have grown more dynamic in recent years, while Russia's budget is in far better shape than a decade ago.

There are also worrying signs in Russia. The economy has become highly dependent on high natural resources prices, and the state has become the central actor in key commercial markets. This is economically sub-optimal. Moreover, Russian manufacturing and technology sectors are weak, and although capital is flowing into the country, it is largely in the form of loans. Corporate debt has soared. Russia is also undergoing a very serious demographic and health crisis. Corruption remains a very critical impediment to further growth.

As countries move to a higher stage of development, as Russia is, institutions become more important and are key to further development. Some analysts argue that as countries move up the developmental ladder, the society itself demands a more accountable and sophisticated institutional structure. In Russia's case, current power relations and the political structure might conspire to thwart these demands. Moreover, there is a kind of categorical confusion that does not bode well for institutional modernization. Russia's big capitalists are not necessarily friends of capitalism. They oppose open competition and free markets and see these as threats. They have a vested interest in blocking institutional change. Colloquial networks are frequently structured to block out new market entrants including foreign investors. Moreover, there is a bifurcation of access to reliable institutions. Privileged and politically connected individuals may enjoy access to reliable institutional structures, while the rest of Russian society is denied this kind of access. Thus property rights vary depending on proximity to the power structure. This is not unique to Russia but it is a serious potential problem, in part, because foreign investors demand a degree of institutional reliability. Investment capital often follows strong institutions and flees weak institutions.

Russia's system relies on a particularly relationship based form of social capital, and many of the top players fear any change in a system which is structured to benefit them. This is also a genuine barrier to domestic market entry, a condition which is weakening entrepreneurial activity. Poor property rights protection is frequently cited by would-be

entrepreneurs as a genuine barrier to market entry. Further economic development of Russia will require an institutional upgrade that opens up the system to more competition and stronger rules of the game. Today stability is given precedence over law.

Russia is also beset with ambivalence about its international posture. Countries that manage to catch up economically do so by linking in to the world economy. China, for example, is deeply engaged with the international community. Russia is far more conflicted about such engagement and needs to find a way to engage internationally in a positive fashion. If it fails to do so, it will continue to operate significantly below its potential.

## **DISCUSSIONS ON THE CAUCASUS AND CENTRAL ASIA**

Members of the Faculty of the School of Oriental and African Studies also addressed the delegation. The first briefing looked at NATO's shifting role in the Caucasus and Central Asia. The NATO Alliance once defined its mission as building a Europe whole and free, but this has evolved into a broader definition of a Eurasia stable and secure. This transition of course was driven by profound strategic change in the post Cold War world, with the first phase culminating in the first NATO enlargement. But concern with institutional integration is now less of a focus than core security issues.

Today there is the emergence of the Shanghai Cooperation Organization, which is offering Central Asia another kind of regional integration agenda. Russia and China have played an instrumental role in this organization, which, among other things, has sought to counter NATO's influence in the region. Georgia, however, remains very intent on Euro-Atlantic integration and ultimately NATO and EU membership. Georgia has repeatedly demonstrated its fidelity to be a reliable and capable partner to NATO and has provided troops for missions to Iraq, Kosovo and to Afghanistan.

NATO's concerns in Central Asia are driven by a number of factors including terror and criminal networks. But within the Alliance there are a myriad of national approaches to the region, ranging from isolation to engagement and outreach. There are also tensions between dealing with existing governments and promoting human rights. Energy security is another critical concern and here a new great game has clearly emerged. Relations with Russia and Iran play an important role in contemporary pipeline politics. Moreover, a number of other countries, including China and Turkey, want pipelines from the region to bring oil and gas directly to their national markets.

## **INDIA**

India was also on the agenda at the university discussion. One analytical problem for those looking at state policy in India is to recognize that it is a federal state and highly decentralized. State parliaments exercise significant powers, and this can lead to tensions with central authorities and policy incoherence. India is also a relatively old democracy in the developing world, and its people have enjoyed universal suffrage since 1951. At its inception, many predicted that Indian democracy could not survive but, in fact, it has. It has a stable parliamentary system, it holds regular, free and fair elections, voter turn-out is high, there is a healthy alternation of power, state powers are significant and the press is vibrant and free. At the same time however, decision-making

is very slow, and reform has not been advanced as quickly as many had hoped. Equity distribution is a central priority of the Indian people, and this complicates the reform process.

Over the long term, economic development will be shaped by several factors not discussed in the NATO PA report: demographic factors, India's very weak infrastructure and education. The foreign direct investment pouring into India is very concentrated in a few regions of what is a vast country. Moreover by 2025, India will likely surpass China as the world's most populous country. This is going to pose significant challenges. The country's people are young, and many Indians harbour expectations for better lives. Yet, most Indians live in the countryside and are working in sectors that are not experiencing growth. Uttar Pradesh and Bihar will grow the most in population, and they are very poor. Indeed India's most impoverished regions are set to undergo the greatest population growth, and in India the impoverished tend to vote more than the middle classes. India is likely to experience severe stresses on its infrastructure and social structure a growing urban-rural split seems very possible. Moreover, India's demands for imported energy will soar. This, too, will be a source of serious economic and international tension.

Speakers from the Foreign Office suggested that while manufacturing is growing in India, it is doing so at a pace significantly below that of China. China occupies the number five position in the global trade rankings, while India is only 24th. Still, its level of trade has trebled since 2001. In terms of foreign direct investment, India ranks 18th and China ranks 3rd.

While India has resisted adopting Western standards on climate change and has allied itself with the Bush Administration's position on the Kyoto Protocol, the British are working to engage both countries in a dialogue on climate challenge. India is particularly threatened by a warming climate and its poorest people are the most vulnerable. India's neighbourhood is also beset with economic and security problems and the British see it as playing a very important stabilizing role. This is particularly evident in Afghanistan where India has launched a substantial bilateral aid program.

## **AFGHANISTAN**

The delegation also met with members of the House of Commons Select Committee on Development to discuss its recent report on Afghanistan, which, like the NATO PA Sub-Committee's report, looks at the challenges in that country through a development lens. The Commons Select Committee visited Afghanistan in October. Members of that Committee agree that engagement in Afghanistan is an essential priority.

Members discussed the problem of poppy production, which has expanded rapidly in the country. Afghanistan is the source of roughly 90% of the world's opium and it is made very easy for farmers to sell it. Indeed, it is frequently sold at the farm gate whereas food crops have to be transported to market at considerable financial and sometimes personal risk to the farmers. Policing represents another serious challenge. Afghan police forces are riddled with corruption. The police problem is a fundamental factor in alienating the public from the state and needs to be corrected.

Britain and America's experience in Afghanistan and Iraq have imparted a range of useful military lessons. Above all, in a counter-insurgency effort, the military dimension is only part of a broad multifaceted endeavour. General Petraeus and US Ambassador Ryan Crocker recently made this very clear in testimony to the US Congress. There have also been a range of tactical lessons that have sharply altered training and equipment. But operationally and strategically, these experiences have suggested how complex the challenge is and the degree to which Western governments and militaries must cope with uncertainty.

The conversation on development challenges continued with representatives of the Department for International Development who stressed how difficult the challenges in that country are. In 2001 Afghanistan had no government to speak of, and it was one of the poorest countries in the world with extraordinarily low life expectancy and literacy rates. Given that starting point, one can see many positive developments in that country. Infant mortality rates are falling, millions of children are being educated, the government has developed the capacity to deliver benefits to the society, including security in much if not all of the country. 70% of the attacks in Afghanistan are taking place in 10% of the districts. Poppy production is also evident in fewer regions than before, although the volume has not diminished.

Building the capacity of the Afghan state represents a key priority of the UK and the problems are myriad and complex. Corruption is particularly worrisome and Transparency International ranks it in 117th position of 159 countries reviewed. Donors are aware of the problem, but this should not dissuade donors from working to reinforce the Afghan budget and to channel aid through the state. The World Bank has audited budgetary disbursements and reports that there are clear indications of improvements.

The British government also welcomes the appointment of Kai Eide to oversee overall coordination of the international effort in Afghanistan. If he is able to carry out his mission, aid effectiveness should be enhanced. A number of countries, including the United States, have become more aware of the problem of aid duplication and failing to run funding through the state budget of Afghanistan, and it is an auspicious moment to seek better coordination on this front. The US, which is the largest donor to Afghanistan, now seems willing to fund more of its aid through the Afghanistan Trust Fund, which is an international vehicle for deepening aid coordination.

The delegation also met with officials from the Foreign Office to discuss several topics including US-British relations. Prime Minister Gordon Brown has been working to reconfirm Britain's special relationship with the United States and recently met with all three presidential candidates. He has identified the key common challenges as climate change, Iraq, Afghanistan, Iran and Africa. The sense is that all three US candidates will consider global warming as priority.

## **GLOBAL FINANCIAL TURBULENCE**

The meetings concluded in discussion with officials from the British Treasury to discuss the origins and characteristics of current global financial instability. The rise of the originate and distribute model of banking has created regulatory loopholes by allowing the securitization of diverse packages of lending operations and reselling these as new securities. This has created new income streams for banks and has had the beneficial

effect of spreading the risk of lending beyond the banking sector. This was also generally thought to create an added degree of stability within the banking system. Yet this same system of weakened the link between the banks and borrowers. Structured Investment Vehicles were increasingly used in the banking system. These products arbitrated between short and long-term interest rates and required a high degree of short lending among banks. Many were given high ratings by the rating agencies which did not adequately reflect their inherent risks.

The sub-prime loan crisis exposed the failure of the financial system to assess the risks posed by these new products. This precipitated a crisis of confidence and banks became very reluctant to lend to each other, which, in effect, caused credit markets to seize up. The banks had little faith in each other's balance sheets. The complexity of some of the originate and distribute products held by the banks and the crashing housing market in the United States thus caused a kind of chain reaction. Bear Stearns in the US and Northern Rock in the United Kingdom were early victims and their difficulties, as well as falling equities and rising commodity prices, have exacerbated global economic uncertainty in recent months.

It was at this point that central banks stepped into the breach to provide much needed liquidity into a market that had essentially frozen up. This helped allay credit fears and increased confidence in money markets. Because many underlying market fundamentals are still strong, confidence has begun to return. There is now a widespread recognition that greater market transparency is needed to moderate market instability. It is clearly difficult to assess risk when securities are essentially cut up into smaller units and repackaged as securities of securities. Greater information is needed so that investors are positioned to understand the risks that they are taking on board. Both bankers and regulators are learning a great deal from the experience and changes in the regulatory environment are very likely.

Respectfully submitted,

Mr. Leon Benoit, M.P.

Chair

Canadian NATO Parliamentary Association (NATO PA)

## Travel Costs

<b>ASSOCIATION</b>	Canadian NATO Parliamentary Association (NATO PA)
<b>ACTIVITY</b>	Visit of the Economics and Security Committee Sub-Committee on Transatlantic Economic Relations
<b>DESTINATION</b>	London, United Kingdom
<b>DATES</b>	April 23-25, 2008
<b>DELEGATION</b>	
SENATE	
HOUSE OF COMMONS	Mr. Leon Benoit, M.P. Mr. Roy Cullen, M.P.
STAFF	
<b>TRANSPORTATION</b>	<b>\$13,428.26</b>
<b>ACCOMMODATION</b>	<b>\$1,753.87</b>
<b>HOSPITALITY</b>	<b>\$0.00</b>
<b>PER DIEMS</b>	<b>\$802.93</b>
<b>OFFICIAL GIFTS</b>	<b>\$0.00</b>
<b>MISCELLANEOUS / REGISTRATION FEES</b>	<b>\$0.00</b>
<b>TOTAL</b>	<b>\$15,985.06</b>