

The EU-US economic partnership in an era of globalization

Jacques Mistral

The EU-US relationship has been the backbone of international relations since WWII. In the recent years it went through a period of stress. Despite excellent cooperation in many aspects of the war on terror, political tensions have been visible at various moments, but economic and financial relations during this period remained unhurt. For sure, a few episodes were reported, and amplified by the media, such as the renaming of “French fries”. But the flows of trade and capital were never hurt and the cooperation between ministers of finance remained active and confident. The reason is clear: globalization raises a lot of difficult issues, growth, trade, exchange rates, good governance, development... coping successfully with these challenges requires a strong transatlantic partnership. This paper aims at surveying some of these challenges and describing where we are going.

Promises of a strong partnership

One of the defining features of the global economy over the past decade has been the increasing integration and cohesion of the transatlantic economy. Let me start by a few figures. Exports from the US to the EU amount to \$151 billion, the exports from the EU to the US to \$220 billion; similar figures for the US-China relations are \$28 and \$152 billion, for US-Japan relations \$52 and \$118 billion. Trade flows between Europe and the US are clearly the biggest share of the pie. And, most importantly, they do not show up a huge disequilibrium.

But a trade-only view is strongly misleading because globalization means global production and the 1990's were a period of extremely rapid development of foreign direct investment (FDI). This surge in FDI did not so much flow to promising emerging markets, as it is frequently supposed, but rather the bulk of these capital flows went through the Atlantic, and became more and more the real anchor of the EU-US

relationship. FDI between the two continents is as high as \$890 billion for European investments into the US economy, US direct investment in the EU reaching \$650 billion. The total output of foreign affiliates in each other's market significantly exceed trade flows, at more than \$300 billion in both the EU and the US.

When it comes to the bottom line, Europe consequently remains the most important region in the world for corporate America. According to data collected by the Center for Transatlantic Relations at Johns Hopkins University, Europe accounted for half of total global earnings of US companies as measured by US foreign affiliates income. Finally, the bulk of American and European overseas workforce does not happen to be in low-wage nations but again in Europe or America: Adding direct and indirect employment, the American affiliates of European companies employ more than 10 million people; and the same is true of the European affiliates of American companies.

The transatlantic dialogue, promises and weaknesses

The 1990's were a period of great opportunities. The fall of the Berlin wall opened, according to many observers, a period of promising economic diplomacy. Maintaining a strong alliance in a period of peace would more and more rely on the strength of economic relations. From this shared perception derived a series of transatlantic initiatives during the 1990's. Early on in the decade, a “transatlantic declaration” solemnly reaffirmed the common involvement towards an open world economic system. Other steps followed during the 90's: annual summits, ministerial consultations, a “New transatlantic agenda” in 1995, a “Transatlantic economic partnership” in 1998, a series of transatlantic dialogues for various constituencies: business, legislators, environmentalists... the first of those being the only one to have reached some maturity. Broadly speaking, this architecture proved complex and its achievements, undoubtedly positive for the business community, frequently turned out to be below expectations.

In any case, 9/11 tragically changed the context. Security and defence came back to the forefront of the international agenda. In American views, Europe lost its central strategic role on the international stage; the European Union, which is strong and united when trade issues are at stake, is weak on strategic and military affairs and will probably remain so for a while after the recent fate of the Constitutional Treaty. Does that mean that the economic agenda has to be shelved? Certainly not, simply because globalization clearly calls for good governance and leadership. As Stanley Fisher recently remembered in an address to the American Economic Association, history teaches that the future of an open economic world can never be taken for granted. It is the responsibility of major industrialized countries to work hard in order to build a better framework for growth and prosperity.

The conclusion is clear, the years since the end of the cold war have witnessed one of the greatest periods of transatlantic economic integration. Our mutual stake in each other's prosperity has dramatically increased. Ambitions must be in line with these realities, actions must avoid policy errors which could only cause significant damage to our own interests.

Coordination of macroeconomic policies

Reasons for acting together are regularly expressed by the Secretary of the Treasury and his G7 counterparts: it's a question of accelerating growth and a question of correcting international imbalances. There is no difference regarding objectives, but a difference in emphasis.

Following the shocks of the early 2000's, the US adopted a very aggressive policy, sustaining final demand through huge tax rebates, increased expenditures and an accommodating monetary policy. Following a long term trend, the savings rate continued to decline and recently reached a historically low level of 0.4%. The deterioration of the current account and the reappearance of the "twin deficits" raised new concerns in particular from international institutions like the IMF or the OECD. Was this policy too lax? How quickly should it be modified?

The question has no simple answer because the European economy does not perform so well either but for seemingly opposite reasons: our policies are more cautious, probably by necessity rather than by virtue. Deficits were already high when the cycle reversed and we did not have the flexibility given by huge surpluses. The Stability and Growth Pact proved to be an extraordinarily irritating issue even if, in practice, it did not compel any manifestly wrong decisions. The European Central Bank itself did not take any counter productive decision even though its mandate, much more than the Fed's, is to focus on inflation. Savings rates are extremely high, in line with frequent calls to prepare for an "ageing population", but possibly too high in this part of the cycle. Was this policy too cautious? Should it be modified? In any case, it is clear that rebalancing the engines of growth on the two continents has to be managed extremely carefully to avoid any collateral damage.

Structural reforms

More fundamentally, growth rates and external balance depend on structural factors. Slow growth in Europe unsurprisingly motivated innumerable proposals for structural reforms, the Secretary of the Treasury recently made a vibrant call in this direction. It's fair to say that every European government is deeply convinced that reforms of the welfare state are badly needed. Not to say that nothing has been done, on the contrary. Many industries have been deeply restructured, think of the car or steel industries, companies have been privatized, the markets for goods and services have been deregulated, as airlines or telecommunications exemplify.

All in all, nevertheless, unemployment remains high in most countries; and productivity is lagging vis-à-vis the US—even if the data deserve a more careful look than they usually receive. More flexibility on the labour market, deregulation of the goods markets, and financial integration at the European level are among the main lessons raised in Europe from the American experience. Would only one aspect be emphasized, I would say that there is no other field than higher education and research where the excellence of the American model is more powerful.

In that sense, cooperation is a sort of emulation, we know that we could do better and which direction to explore, which priorities to select. The 2000 Lisbon Agenda rightly describes the future of a more competitive European economy. Governments are at work, but they are facing challenging tasks: reforms are underway everywhere but the speed and the scope of changes appears, as the Kok report recently stressed, still disappointing.

On the other side, we think that the European experience can, in certain aspects, be valuable for the US economy. The most striking example is energy where market and environmental considerations are involved. Oil is in short supply, both in the short and the medium term; sustaining growth requires a more efficient use of this resource. Per unit of real GDP, consumption in Europe is half as large as in the US, a comparison which convincingly exemplifies large possibilities of using more efficient technologies in this country. The same is true in the environmental arena. True, America, with its size and vast natural resources, has been at first less sensitive to this new dimension of world interdependences than more heavily populated countries. In any case, and according to OECD data, CO₂ emissions are in Europe half what they are in the US per unit of GDP. Rejecting the Kyoto agreement for its poor technical formulation is understandable but the treaty also has a political dimension. A similar point can be made with electricity since nuclear reactors are clearly the most efficient contribution to a better environment. This is an industry where the partnership between Europe and the US should naturally be promising.

Trade issues

Trade negotiations have been up and down for many years but the overall impression is one of good cooperation between us. After Seattle, our main negotiators, Pascal Lamy and Bob Zoellick, succeeded in relaunching the round in Geneva last July. The European Union, in particular, accepted significant concessions on the most sensitive issues, agriculture. The momentum now seems promising in the US; the five-year exam of the WTO agreement successfully passed in Congress; the renewal of the TPA and the adoption of CAFTA will be major trade issues in Washington in the coming months; they should not divert the attention from achieving a successful conclusion to the round in Hong Kong at the end of 2005.

Bilateral issues are frequently presented as more contentious, and I won't even mention the episode of the "freedom fries" which quickly proved a non-starter. In my view, two very serious questions have recently developed in a good direction. First, Genetically Modified Organisms (GMOs). This is as sensitive an issue in the US as it is in Europe, the former accusing the latter of scientific obscurantism and mercantilism, the latter denouncing the former for its contempt for good and secure food. The US requested a panel from the Dispute Settlement Body (DSB); in the mean time, the EU adopted new regulations (similar to those of the US Food and Drug Administration) and consequently cancelled its moratorium for GMOs which was the basis of the complaint. Now, the discussion will leave the dangerous field of principles (Science vs. Precaution) and come to technicalities which are more manageable.

Another poisonous issue has been, for many years, the question of American tax and anti-dumping measures which had been regularly condemned by the DSB. The most important part of these complaints was related to the successive versions of the FSC (Foreign Sales Corporation), a fiscal disposition which had been equated with disguised subsidies benefiting US export industries. After long deliberations and facing increasing European sanctions, Congress recently adopted a huge tax package essentially bringing American tax laws in line with WTO requirements. Even if some significant details remain in discussion—without prejudice to the remaining Byrd amendment—these movements are clearly good news. Unfortunately, a new spectre appeared recently on the horizon, the Airbus Boeing case.

The competition between European and American aircraft manufacturers has been guided for more than 10 years by the 1992 agreement which avoided any conflict in this highly sensitive industry. For many industrial, financial and strategic reasons, the relationship between the State and an aircraft manufacturer are unavoidably intense and diversified. Many avenues can be used to achieve this goal, State subsidies can easily lead to a disordered competition. The bilateral agreement recognized this reality and precisely attempted to properly manage public intervention on both sides of the Atlantic, and it worked for a decade. However, Boeing's former CEO Harry Stonecipher early in 2004 announced he would be "raising the rhetoric" on what he alleged are "unfair subsidies", which in effect have always been in line with the agreement. During the presidential campaign, the US government decided to ask for consultations at the WTO, and the EU immediately raised the reverse case. "Consultations" failed and, contrary to a frequent view in Europe, the US asked for a Dispute Settlement Body panel, a move quickly followed by the reverse demand from the EU. An all-out trade war would probably cause serious damage to the entire industry. Aggressive rhetoric is no help in this process; definitely needed is a substantive dialogue leading to a mutually acceptable resolution.

The dollar-euro relationship

Let me now come to monetary and financial questions where the relation between the dollar and the euro are at the forefront. Globalization means that we more and more live in a world of free capital movements and market-determined exchange rates. This is absolutely true for the transatlantic economy. To be exact, this is not true everywhere since a major part of Asia still works in a more rigid or administered framework. In any case, the world economy needs a reserve currency, a role performed by the dollar since WWII. The attributes of a reserve currency are well known: it is the currency of a powerful economy, with a well developed financial sector, and with deep and diversified relations with the rest of the world. No other economy fits this description better than the US. For sure, the euro has, as Alan Greenspan noted in a 2002 speech, many features of a reserve currency and it could be one in the future; but he very judiciously added that it was presently no real competitor to the dollar: its use on financial markets remains limited as well as its utilisation by central banks, most importantly, a lagging European economy was not attractive as far as portfolio diversification is concerned.

After its creation, the Euro in effect followed a relatively chaotic path. Contrary to many expectations, the euro did not perform well in its early phase; starting at 1.19 dollar per euro in 1999, the new European currency fell as low as 0.88 in 2001. This level was clearly not based on economic fundamentals; it was the product of a self-propagating movement, an over-reaction of the exchange markets. Three years later, the Euro reaching 1,36, the insisting question became the reverse: is there now a risk of a similar over-shooting in the opposite direction? The Euro reaching 1,6... 2 or even more? Such figures were heard at the respected Institute for International Economy. Months later, in the mid 2005, the exchange market again is in a very different mood: the no-votes in France and the Netherlands have raised new concerns about the future of the European currency.

In any case, the fall of the dollar should not be a surprise; it had to be, at one moment of time, the logical outcome of the current deficit which is now running at a rate higher than \$600 billion, not far from 6% of GDP. In 2005, the reasons for a continuous decline of the dollar are more and more evident in the economic community in the US; and the later, the stronger, that was for example the message of the last Brookings Panel on Economic Activity. Despite the most recent trends, an increased volatility on the exchange markets remain a significant danger. As J.-Cl. Trichet recently noticed, "excess volatility and disorderly movements in exchange rates are undesirable for economic growth".

In this context, accusations could promptly come back from both sides of the Atlantic: "insufficient savings", "poor growth", "lack of flexibility"... The blame game, which briefly started during the autumn 2004, is an easy one; it's always the

other's guy! But there is no point in naming and shaming anyone. Would unwise policy decisions be adopted to cope with these imbalances, we know that the world economy could suffer very damaging consequences. As an example, everyone has in mind the catastrophe scenario: hard landing of the dollar, increased interest rates, bursting of the housing bubble and/or a financial market crash. An American recession would follow and the world economy could certainly not escape the consequences of such a downturn.

As international monetary affairs are at stake, cooperative solutions are definitely desirable. According to a recent motto: "the deficit is a shared responsibility". That's correct. But going into details reveal a paradox: one, the US deficit is not a deficit with Europe, it's a deficit with Asia; two, the flexibility of exchange markets is not with Asian currencies, it's with European ones. Most observers recognize now that further adjustments of the dollar should take place against other currencies: this is for example the conclusion of the most recent book by Fred Bergsten and John Williamson from the International Institute of Economics (IIE). The scope of a cooperative solution is consequently really a global one; after all, it is the central responsibility of the IMF, according to its statutes, to overlook the balance of payments problems and the external monetary arrangements of its members. As Bretton Woods and the Plaza Agreements show, the main ingredients for international monetary cooperation are a strong US leadership and a common understanding of the issues between the US and Europe. These are the keys to achieving a Plaza 2 agreement.

Conclusion

Let me in conclusion emphasize a few points. Our world is a world of interdependence which means both opportunities and challenges. The transatlantic relationship remains, by far, the most important intercontinental connection in the present era of globalisation. It is good news that the economic partnership between America and Europe did not suffer from recent political turbulences. To make globalization work, two elements are needed: initiative, in a Schumpeterian sense, has to be rewarded, that's the particular gift of America to the world economy; a sense of discipline is required for insuring a proper functioning of international economic relations; could that be a useful contribution of the EU? International differences are the basis for trade, competition, innovation; but they can also be a major source of misunderstandings or frictions. This is why it is so important that the transatlantic partnership being extended: this is the best way to make sure that structural reforms, trade relations and monetary arrangements are well designed to reinforce the basis of our common prosperity.

Concordia is the daughter of Mars (USA) and Venus (Europe)

Madeline Albright

Former secretary of State

As everybody knows me, I am an optimist. But I think one can very well agree that the world is not in a great place. Also, I have never been to any conference, especially with economists that says that everything is going well... Otherwise there would be nothing to discuss.

As somebody who was born in Europe, I am a little schizophrenic because I worry about my children but I tell them to "go do it". What we are supposed to do is really look at comparative attitudes towards transatlantic relations and what I thought I would do is give a few background facts, look at some specific situations and then look at things that we have to do together.

Now for my whole discussion, I have several provisos. In listening to everybody, we are talking as if there were one Europe. There is not one Europe, there are a variety of Europes. It can be divided into North-West, South and Central or Eastern or whatever division, but we have here been talking about one Europe and I do not think that is accurate. Also I think we have to understand that America is very complicated. We are one country, but everybody now knows about the Red and Blue, I can assure that not everybody agrees with President Bush and Richard Perle. Some in fact wish for bi-partisanship, I am one of those, and some like it the way it is. Those are my first two provisos.

The third one is that there is a little bit of nostalgia involved and even though I think of myself as the embodiment of US-European relation having been born here and become a naturalized American, I have to admit that I did have a few problems with Europeans. And when my good friend Hubert Védrine and I used to get together for our *tête-à-têtes*, I at first started being very sentimental and I said "You know we really did have this great relationship and Lafayette