

# **Arbeitspapier/Dokumentation**

herausgegeben von der  
Konrad-Adenauer-Stiftung e.V.

Nr. 106  
Stefan Fröhlich (ext.)

## **Globalization and the Future of Transatlantic Relations**

Sankt Augustin, April 2003

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## **CONTENTS**

<b>INTRODUCTORY REMARKS</b>	<b>3</b>
<b>I. DEBATING THE PROS AND CONS OF GLOBALIZATION</b>	<b>4</b>
<b>II. THE CURRENT TRANSATLANTIC ECONOMIC GAP - THE RESULT OF A NEW SYSTEMIC CONFLICT?</b>	<b>11</b>
<b>III. ARE WE DRIFTING APART? TRENDS IN U.S.-EU RELATIONS</b>	<b>13</b>
<b>IV. TRADE TENSIONS DO NOT REALLY MATTER</b>	<b>15</b>
<b>V. GLOBALIZATION - TWO POINTS OF VIEW</b>	<b>18</b>
<b>VI. CONSEQUENCES FOR TRANSATLANTIC COMPETITION</b>	<b>23</b>
<b>VII. HOW TO OVERCOME THE STRATEGIC DIVIDE – PROSPECTS FOR CONVERGENCE</b>	<b>26</b>
<b>CONCLUSION</b>	<b>31</b>

### *Introductory remarks*

Globalization - the increasing integration of international markets being brought about by the rapidly expanding worldwide flow of ideas, goods, services, information, capital, and sometimes people - has polarized people throughout the world.<sup>1</sup> The world has previously experienced successive waves of what we today call globalization, all of which share certain characteristics with this latest development: the expansion of trade, the diffusion of technology, extensive migration, and the „cross-fertilization of diverse cultures“.<sup>2</sup> More recently, however, globalization has been reinvigorated by at least three factors:

First of all, we are now experiencing an unprecedented exchange of information, thanks to breakthroughs in computer and telecommunication technologies which have reduced real computing and communication costs by almost 100% since 1970. This technological progress has steadily expanded the range and quality of services that can be traded, including those supporting trade in goods, thus moving the world toward a globally integrated economy.

Secondly, international trade has increased by 6% in recent years, while world economic growth rates averaged 3%, ranging from a high of 5% in the U.S. to a low of zero in Japan.<sup>3</sup> The share of global exports in world GDP increased from 14% in 1970 to 24% in 1999.<sup>4</sup>

Thirdly, capital and financial market integration has also advanced substantially in recent years. Annual global flows of Foreign Direct Investment (FDI) surged to a record \$827 billion in 1999 (10 times higher than in the 1980s), with 25% directed to less developed countries, up from 17% in 1990.<sup>5</sup> In the 1970s, daily foreign exchange transactions averaged \$10 billion - \$20 billion; today, the average daily activity has reached more than \$1.5 trillion.<sup>6</sup> Nowadays, money has lost its function to reflect and promote the production process, and its transactions as financial circulation have become independent. Uncontrolled money and capital flows

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<sup>1</sup> Robert Keohane, Joseph Nye, Globalization: What's new? What's not? (And so what?), in: Foreign Policy, 118 (Spring 2000), pp. 104-119.

<sup>2</sup> Eduardo Aninat, Surmounting the Challenges of Globalization, in: Finance and Development. A quarterly magazine of the IMF, 39, 1 (March 2002), p. 2; for a useful definition see Daniel Griswold, The Blessings and Challenges of Globalization, in: The World and I, 15, 9 (September 2000), pp. 267-283 (267).

<sup>3</sup> OECD, Main Economic Indicators, May 2000, p. VI.

<sup>4</sup> Alan Greenspan, Technology and Trade. Speech given at the Dallas Ambassadors Forum, April 16, 1999,. Available at: <http://www.federal.reserve.gov/boarddocs/speeches/1999/19990416.htm>.

<sup>5</sup> UN Conference on Trade and Development: World FDI grows 25 Percent in 1999. Press Release, February 8, 2000.

<sup>6</sup> United Nations, Human Development Report 1999, p. 25.

cause autonomous interest and exchange rate movements, distorting prices and locational conditions in a globalized market. Only 5% of all foreign currency dealings are used to finance international trade, while the remaining 95% are speculative and follow different motives, i.e. the return on money due to different interest rates and locational factors.

### ***1. Debating the pros and cons of globalization***

Aside from all the impressive figures and numbers certifying the extent of globalization, what kind of impact is globalization actually having on national economies? Is this a development to be welcomed? Economic theory, as represented by the Heckscher-Ohlin-Samuelson model of trade, suggests that a fully integrated world economy provides the greatest scope for maximizing human welfare. This proposition is based on assumptions about the free international movement of goods and factors of production (capital and labor), the availability of information, and a high degree of competition. All these factors contribute to three fundamental blessings of globalization for nations that embrace it: faster economic growth, reduction in poverty, and more fertile soil for democracy. But benefits accrue even if capital and labor cannot move freely, as long as goods are traded freely.

As a matter of fact, globalization has brought increased prosperity to the countries that have participated in this process. Rising merchandise trade has been one of the hallmarks of the globalization process, and the gains from trade liberalization in recent decades have exceeded the costs by a very considerable margin. Any casual survey of the world today will confirm that the greatest beneficiaries of globalization are the long-suffering consumers in those nations that had been „protected“ from global competition.<sup>7</sup> The wealthiest nations and regions of the world – Western Europe, the United States, Canada, Japan, Hong Kong, Taiwan, South Korea, Singapore – are all trade-oriented. In contrast, the poorest regions of the world – the Indian subcontinent and sub-Saharan Africa – remain (despite recent, halting reforms) the least friendly to trade, set on following policies of economic centralization and isolation. Meanwhile, in those countries that have opened up in the last two decades – like China or Chile – globalization has expanded the range of choice, has improved product quality, exerted downward pressure on prices, and has delivered an immediate gain to

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<sup>7</sup> Jeffrey Frankel, David Romer, Does Trade cause Growth?, in: American Economic Review (June 1999), pp. 379-399; Organization for Economic Cooperation and Development, Open Markets Matter: The Benefits of Trade and Liberalization, Paris 1998, p. 10.

workers by raising the real value of their wages. In other words, globalization has helped to raise living standards in many parts of the world, partly also by making sophisticated technologies available to the less developed countries (LDCs).<sup>8</sup>

On the other hand, concerns have grown about the negative aspects of globalization and especially about whether the world's poorest, the 1.2 billion people who still live on less than \$1 a day, will be able to share in its benefits – despite the fact that during the last decade their numbers have dropped from 1.3 billion, and that it has been cut almost in half in open economies like in East Asia's, down to 15,3%.<sup>9</sup> The belief that free trade favors only rich countries and that volatile capital markets hurt developing countries the most have led activists of all kinds to come together in an „antiglobalization“ movement.<sup>10</sup> The activists blame globalization as the source of numerous problems, ranging from the costs of rapid economic change to the loss of local control over economic policies and developments, and from the disappearance of old industries and the destruction of native cultures to increasing poverty.

In separating the different meanings of globalization, it becomes obvious, as Nobel Prize winner Joseph Stiglitz put it, that in many countries globalization has brought about „huge benefits to a few with few benefits to the many. But in the case of a few countries, it has brought enormous benefits to the many.“<sup>11</sup> The reason is that globalization simply has meant different things in different places.

Firstly, for LDCs engaging in the global economy, globalization allows access to much larger markets, both for imports and exports. On the import side, consumers gain access to a much larger range of goods and services, raising their standard of living, while domestic producers gain access to a wider range and quality of intermediate inputs at lower prices. On the export side, domestic industries profit from a quantum leap in economies of scale by serving global markets rather than only a confined and underdeveloped domestic market. For instance, the growth of East Asian countries has been based on exports, and as a result, real incomes in

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<sup>8</sup> Jay Mandle, Reforming Globalization, in: Challenge, 48, 2 (March/April 2001), pp. 24-38 (24).

<sup>9</sup> World Bank, Assessing Globalization: Does more International Trade Openness increase World Poverty? PREM Economic Policy Group and Development Economics Group (April 2000).  
<http://www.worldbank.org/html/extdr/pb/globalization/paper2.htm>

<sup>10</sup> Jagdish Bhagwati, Coping with Antiglobalization: A Trilogy of Discontents, in: Foreign Affairs, 81, 1 (January 2002). Copy by the Council on Foreign Relations, pp. 1-4.

<sup>11</sup> Joseph Stiglitz, Globalism's Discontents, in: The American Prospect, Special Supplement Winter 2002. Globalism and the World's Poor, pp. A16-21 (16).

East Asian economies like Korea's have doubled every 12 years since 1960. Since 1980, South American countries like Chile have boosted their shares of world trade and per capita incomes by embracing globalization.<sup>12</sup>

Secondly, LDCs that have opened up to international markets have gained access to much higher levels of technology and knowledge, thereby improving their population's health and life spans.<sup>13</sup> Rather than having to shoulder the costs of expensive, up-front research and development, poor countries have been able to import the technology off the shelf, much of it in the shape of imported capital equipment – that is, machinery that raises the productive capacity of the country. Subsidiaries of multinational companies also introduced new production techniques and employee training that bolstered the host nation's stock of human capital. In this context, it is important to note that trade barriers in rich countries have put the developing world much less at a disadvantage than is often claimed by critics. Tariffs in poor countries are more than four times higher than those in the industrialized nations, and trade barriers between poor countries are often more significant restraints to development than those imposed by rich countries.<sup>14</sup>

Third, engaging in the global economy provides capital to fuel future growth. Most LDCs are people-rich and capital-poor. In most LDCs, the domestic savings are inadequate. Capital inflows can fill the gap, contributing to growth by stimulating investment and technical progress and promoting efficient financial development. Openness to capital flows, when combined with sound domestic economic policies, gives countries access to a much larger pool of capital with which to finance development and more traditional types of infrastructure, such as port facilities, power generation, and an internal transportation network. And just as importantly, transnational companies can provide an infrastructure of what could be called „enabling services“, such as telecommunications, insurance, accounting, and banking. As China and India have shown, a protected and inefficient service sector does weigh down an entire economy, slowing the development of manufacturing and other industries.<sup>15</sup> FDI in particular, as opposed to potentially volatile portfolio flows, speeds up both capital accumulation and the absorption of foreign technologies and, like trade, has been

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<sup>12</sup> World Bank, *Globalization, Growth and Poverty: Building an Inclusive World Economy*, World Bank Policy Research Report, New York: Oxford University Press for the World Bank, 2002.

<sup>13</sup> David Dollar, Aart Kraay, *Trade, Growth and Poverty*, World Bank Policy Research Working Paper No. 199, Washington 2001.

<sup>14</sup> Jagdish Bhagwati, *The Poor's best hope*, in: *The Economist*, 363, 8278 (June 22-28, 2002), pp. 24-26.

<sup>15</sup> Griswold, *op. cit.*, p. 271.

shown to promote economic growth. Or, to put it in an other way: Both the level of economic development and the level of human welfare are closely related to FDI.<sup>16</sup>

This relationship prevails not only when comparing developed and poor nations, but also when the poorer countries are ranked by their level of development. Among the thirteen largest underdeveloped countries in the world, the human development index is lowest where FDI is lowest. Conversely, the measure of well-being stands at a relatively high level in the LDCs where FDI is relatively high.

Fourth, engagement in the global economy encourages governments to follow more sensible economic policies. Globalization has raised the costs that must be paid for bad policies. Countries that insist on following anti-market policies will find themselves being excluded from the global competition for investment. As a consequence, nations have a greater incentive to choose policies that encourage foreign investment and domestic, market-led growth and that, above all, contribute to greater political and civil freedom in a number of countries.<sup>17</sup> Taiwan and South Korea were essentially dictatorships two decades ago, but are now governed by elected legislatures and presidents. In Latin America, the movement toward economic liberalization has been intertwined with a flowering of representative government. Chile, a leader in economic reform, now enjoys one of the region's most stable democracies. Similarly, Mexico today has a much more open political system.

The advance of globalization, however, has not been a smooth or painless process. At least two important qualifications are necessary to the notion that globalization is unprecedented, increasing and beneficial to all.

First, the number of developing countries and groups within these countries that have benefited from growing trade and direct investment – mostly in East Asia, Brazil, Mexico and now China – have indeed been very few, not more than a dozen, and have not included the poorest developing countries. At the turn of the century, twelve countries in Asia and Latin America accounted for 75% of total capital flows before the Asian crisis, while 140 of the 166 LDCs accounted for less than 5% of inflows.<sup>18</sup> The largest share of foreign investment is

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<sup>16</sup> PPP gross national product per capita: World Development Indicators 2000, Washington DC: World Bank 2000, table 1.1.

<sup>17</sup> Thomas Friedman, *The Lexus and the Olive Tree*, New York: Farrar, Strauss and Giroux, 1999, p. 86-87.

<sup>18</sup> Alejandro López-Mejía, *Large Capital Flows: A Survey of the Causes. Consequences and Public Responses*. IMF Working Paper 99/17, Washington 1999.



made by companies from a handful of countries, in a narrow range of industries. In fact, the bulk of the international flow of goods, services, direct investment and finance is between the U.S., Europe and Japan. Indeed, more than 80% of the world's population living in developing countries account for less than 20% of world income.<sup>19</sup> In other words, the perception exists that economic liberalization has exacerbated the gap between rich and poor countries, and between rich and poor within countries that have liberalized.

Second, many critics claim that globalization undermines labor and environmental standards. Their fear is that advanced nations would be forced to weaken social and environmental standards to compete with less-regulated producers in developing countries. Thus, the thinking goes that lower standards would give LDCs a significant advantage in attracting capital and gaining export markets at the expense of the OECD world.

Third, FDI constitutes a smaller portion of total investment in most countries than ever before, because government savings do play a greater role today than in the past and due to floating exchange rates that raise uncertainties in certain economies and are a barrier to long-term investments. The same point can be made for capital flows: Though gross capital flows are very large, net flows are not. Current account deficits and surpluses now represent a much smaller proportion of countries' GDP than in the past. But the fact remains that this is surprising in view of the talk of the globalization of capital markets. The bulk of foreign investment has been the USA's capital import and the outflow from Japan. Apart from that, today's foreign investment is more broadly based, short-term, speculative, and less stable.<sup>20</sup>

But even these qualifications have to be qualified again. It is true that a large number of countries have fallen behind. But those poor nations have almost uniformly clung to state-directed and inward-oriented economic policies. Sub-Saharan Africa has lagged behind the rest of the world in economic growth largely because its markets remain among the most closed in the world, since the government has neglected domestic investments in infrastructure and reasonable domestic policies. There is a strong correlation between economic freedom and both economic growth and per-capita GDP. In the early nineties nations in the top fifth grew almost three times faster (2.9 % annually) on average than those

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<sup>19</sup> United Nations Development Programme: Human Development Report, New York 2000.

<sup>20</sup> Paul Streeten, Globalization. Threat or Opportunity?, Copenhagen Business School Press 2001, p. 16-17.

in the middle fifth while those in the bottom fifth saw their economies shrink an average of 1.9%.<sup>21</sup>

With regard to the undermining of social and environmental standards, there is no strong evidence that there is a positive association over time between sustained trade reforms and improvements in those standards. As a matter of fact, the real competition is toward the top. For reasons of internal efficiency, transnational companies sometimes try to impose even higher standards on their overseas production than those prevailing in local markets, thus raising average standards in the host country. Free trade and domestic liberalization are the best means to achieve higher standards. As per-capita incomes rise in developing countries, so does the pressure on domestic markets for higher standards, and the ability of the productive sector to pay for them. Besides, in recent years outsourcing came to the rescue of many transnational companies, as it allowed them to move the cost-intensive parts of their production abroad while at the same time leaving the final production with the parent company in the home country.

Last but not least, the biggest problem is with the uncontrolled flow of capital to those countries that have not been prepared for globalization or that have had globalization managed for them by the IMF and other international economic institutions. These institutions have pushed a radical market-oriented economic ideology, arguing for a minimalist role for government, rapid privatization and liberalization,<sup>22</sup> in countries that were not prepared at all in terms of having a broader vision of society and of the role of economics and institutions within society. On the other hand, East Asian economies took advantage of the globalization of knowledge to reduce the disparities between the developed and less-developed countries. While some of them grew by simply opening themselves up to multinational companies, others, such as Korea and Taiwan, grew by creating their own enterprises. In other words, the problem is not with globalization but rather with how it has been managed. This became apparent during the Asian crisis in 1997/98 which was a result of rapid liberalization of financial and capital markets.<sup>23</sup> The huge influx of capital caused speculative real-estate

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<sup>21</sup> James Gwartney, Robert Lawson, Walter Block, *Economic Freedom of the World: 1975-1995*, Vancouver, B.C: Fraser Institute 1996, p. XXII.

<sup>22</sup> John Williamson, *What should the Bank think about the Washington Consensus?* Institute for International Economics. Available at: [www.iie.com/TESTMONY/Bankwc.htm](http://www.iie.com/TESTMONY/Bankwc.htm).

<sup>23</sup> Stefan Fröhlich, *Auswirkungen veränderter Rahmenbedingungen auf das transatlantische Verhältnis*, in: Rainer Meier Walser/Susanne Luther (eds.), *Europa und die USA. Transatlantische Beziehungen im Spannungsfeld von Regionalisierung und Globalisierung*, München: Olzog-Verlag 2002, pp. 279-292 (285-86).

booms, and then as investor sentiment suddenly changed, the money was pulled out again, leaving the host countries with economic devastation, almost incapable of withstanding.

Volatility impedes growth and increases the likelihood of recessions that lead to further impoverishment because of the lack of adequate safety nets. Volatility increases the risks of investing in a country, pushing investors to demand a risk premium in the form of above-average interest rates. Things get even worse, when, on top of it, economic institutions like the IMF demand austerity programs with expenditure reductions, which almost inevitably result in cuts in spending for already threatened safety nets.

## ***II. The current transatlantic economic gap - the result of a new systemic conflict?***

In the past decade, the U.S. dominated the international scene with an unmatched combination of military and economic power, political leadership and even cultural hegemony, the latter stemming from the technological revolution and economic globalization, which together foster the flow of cultural goods; here the key choice is between uniformization (often termed „Americanization“) and diversity.<sup>24</sup> Nowhere else has this dominance - relative to the next richest powers or the rest of the world combined - been more evident than in the economic sphere. For seven years the U.S. has overshadowed its European and Japanese rivals with an unprecedented investment boom and euphoria about the „new economy“. The U.S. economy is currently twice as large as its closest rival, Japan. California's economy alone has risen to become the fifth largest in the world (based on market exchange-rate estimates), ahead of France and just behind the United Kingdom.<sup>25</sup> Washington emerged as the undisputed champion of globalization, attracting more scientifically-trained foreign workers than any other country in the world and more than one-third of world inflows of foreign direct investment. Although it is increasingly difficult to measure national R&D spending in an era in which so many economic activities cross borders, figures from the late 1990s indicated that U.S. expenditures on R&D nearly equaled those of the next seven richest countries combined.

While transatlantic GDP growth rates have been roughly equal in recent decades (2.5 % for the U.S. and 2.2 % for the EU), a major gap in favor of the U.S. began to develop between 1995 and 2001 (3.9 % in the U.S. and 2.6 % in the EU). One cause for this disparity was the increase in the U.S. employment rate by more than 10 % to a high 75 % in 2001, at a time when the employment rate in the EU stagnated at an average 66 %.<sup>26</sup> A further contributing factor was the growing productivity gap. Over the past three decades, up to the mid-1990s, Europeans had been able to narrow this gap progressively to 80 % of the U.S. level. Between 1995 and 2001, however, the productivity rate of EU member states fluctuated between 60 and 80 % of U.S. levels. Only Ireland, Luxemburg, Portugal, and Finnland achieved rates

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<sup>24</sup> Stanley Hoffmann, Clash of Globalizations, in: Foreign Affairs, 81, 4 (July/August 2002), pp. 104-115.

<sup>25</sup> Stephen G. Brooks, William Wohlforth, American Primacy in Perspective, in: Foreign Affairs, 81, 4 (July/August 2002), pp. 20-33 (2).

<sup>26</sup> European Commission, Competitiveness Report 2001, Brussels (November 21, 2001), pp. 19-27.

comparable to those of the U.S. Germany and France prevented even larger disparities during the same period only by making heavy productivity and reorganization investments.<sup>27</sup>

Both factors - the lower level of employment and the average output per employed person - contribute to the gap in living standards vis-à-vis the U.S. When looking at the GDP per capita on both sides, one notices that in the past quarter century, European living standards have not caught up with America's. In the late 1990s, strong U.S. growth led to a wider gap. EU GDP per capita is now less than two-thirds that of the U.S.: this is the widest gap since the 1960s. And after years of stagnation, real hourly wages in the U.S. began rising in the last years, even for the lowest-paid workers.

Following September 11 and the ugly demise of Enron Corp. and Worldcom (which deeply strained faith in corporate America<sup>28</sup>), even now, at times when dangers for the U.S. economy may be lurking just ahead, the current debate about a possible deep and long-lasting recession in the U.S. misses an essential point: The American economy of 2002 is a remarkable sight to behold. At 5.7 % in the spring, the unemployment rate is certainly up from 3.9 % in October 2000. But it is a level that would certainly have signaled near boom times during the 1970s and 1980s. While growth was slow in 2001, it wasn't negative - real GDP actually expanded 1.2 %, a „recession-year performance“ surpassed only in 1960.<sup>29</sup> Real after tax-personal income rose 3.6 % for the year 2001 and productivity nevertheless grew a stunning 5.2 % in the fourth quarter.

After all, U.S. economic policy has been following a reasonably consistent and consistently reasonable course - a mix of:

- moderate Keynesianism in fiscal policy, providing economic stimulus only when times are bad;
- moderate monetarism, trying to keep inflation at bay without being too dogmatic about it;
- moderate free-marketeering, with taxes and regulation being modest by European standards but far from nonexistent;
- and greater responsiveness to economic and financial change.

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<sup>27</sup> Erkki Liikanen, Competitiveness Report 2001. Enterprise Policy Scoreboard 2001. Press Conference, Brussels (November 22, 2001), pp. 2-3.

<sup>28</sup> How to Fix Corporate Governance. Special Report, Business Week, 3781 (May 6, 2002), pp. 68-78.

<sup>29</sup> Justin Fox, The diehard economy. Why the doomsayers keep getting wrong, in: Fortune, 145, 9 (April 29, 2002), pp. 52-58.

At this point, one increasingly has to distinguish between two different economic systems. Competition among such systems takes place within a particular regulatory framework: businesses compete in international markets subject to certain principles and regulations. States compete to retain or attract investment capital and thus strive to improve the climate for economic activity and creativity. They do this with the instruments of their fiscal and structural policy, as well as by creating the necessary infrastructure and labour market policy – in short, through a more or less market-oriented regulatory policy. In the transatlantic context, this type of systemic competition between the Anglo-Saxon model of the United States and the Rhenish capitalism of the EU has existed since the mid-1990s when the American political right became determined to demonstrate the superiority of its preferred market model over that of social democracy. This competition must be seen as the outcome of different economic philosophies as well as of different ways of handling the consequences of globalization on both sides of the Atlantic. The power and persuasiveness of laissez-faire orthodoxy in this context have an important dampening effect on the debate about globalization - portraying globalization issues as a series of black-and-white, either-or choices. Free versus social market economy in the domestic spheres, free trade versus protectionism in foreign economic policies is how the debate is typically framed - as if anyone were advocating either removing all controls over international commerce or permitting no such commerce at all.<sup>30</sup>

### *III. Are we drifting apart? Trends in U.S.-EU relations*

Nevertheless, the difference in both answers to globalization becomes obvious when one examines the effect of the downturn of the U.S. economy on the European market. Europe has been infected by the weak American economy, it is true, but in spite of the enormously dense network of trade relations and huge direct investments, it has been less affected than during previous cyclical downturns. Even during the years of strong growth in world trade, fueled largely by the huge U.S. economic engine, the European economies did not benefit disproportionately. Therefore, it would now be inaccurate to hold the weakness of the global economy or even the September 11 attacks responsible for the lack of economic dynamism throughout Europe, and in Germany in particular.

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<sup>30</sup> Alan Tonelson, Globalization: The Great American Non-Debate, in: Current History, 96, 613 (November 1997), pp. 353-364 (354).

In view of the current power imbalance, Americans often question whether the U.S. even needs international partners. The recent tendency to equate unipolarity with the ability to achieve desired outcomes single-handedly on all issues only reinforces this point; in no previous international system would it ever have occurred to anyone to apply such a yardstick. This has led some observers to warn against increasing American self-righteousness, even hubris, and to view the unbridled stream of capital, goods and services, and information as the underlying cause of future distribution conflicts and of the increasing disparity in the global economy.<sup>31</sup> In this vein Washington is chided for its economic dominance of international organizations like the International Monetary Fund (IMF) and the World Bank, for dollarization, for its failure to support institutional adaptation processes in partner countries (as in the case of the Asian crisis in 1997/98), and for its overly rigid sanctions and export control policy.<sup>32</sup> Recommended remedies include more multilateralism; more restraint in global engagement; strengthening of relations between the U.S. and its most important partners; more regard for international organizations; and increased acceptance of economic diversity that does not necessarily follow American patterns of globalization. On both sides of the Atlantic many equate globalization with Americanization, and Europeans fear being overrun by values they abhor.<sup>33</sup>

In this context, Europeans point to their lower crime rates, the smaller income gap, less inequality in terms of social welfare policy, safer cities, and better-protected countryside. American capital punishment, especially its disproportionate use on black prisoners, has become for Europeans a symbol of the weaknesses of American domestic society and law. America's higher levels of violent crime and wider gun availability have further fueled European disrespect for the American model.<sup>34</sup>

The distaste for American values is matched by concern that the U.S. has caused a strategic split with Europe over matters such as the Comprehensive Test Ban Treaty (CTBT) and National Missile Defense (NMD). To Europeans, Washington's reluctance to join the global land-mines ban, the International Criminal Court (ICC), and the Kyoto Protocol on global warming evidences selfish unilateralism. President Bush's fixation on „states of evil“ is at

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<sup>31</sup> Chalmers Johnson, *Blowback: The Costs of the American Empire*, New York 2000.

<sup>32</sup> Bernard E. Munk, A New International Economic Policy, in: *Orbis*, 45, 3 (Summer 2001), pp. 401-414.

<sup>33</sup> Antony J. Blinken, The false Crisis over the Atlantic, in: *Foreign Affairs*, 80, 3 (May/June 2001), pp. 35-48 (35).

<sup>34</sup> William Wallace, Europe, the necessary partner, in: *Foreign Affairs*, 80, 3 (May/June 2001), pp. 17-34 (28).

best naive, at worst - as in the case of sanctions against Iraq - „genocidal“. At the same time, trade disputes seem to spiral out of control.

By contrast, American observers believe that Europeans should view the growing competitive pressure on their social and fiscal systems exerted by globalization as an opportunity to liberate their economic systems from corporatist restraints, to boost their performance and to adapt them to the requirements of globalization. Specifically, this would mean greater competition of ideas instead of bureaucratic standardization; dealing with the urgent questions of the future instead of getting hung up in discussions about European employment policy; solving the demographic problem that will also affect economic development instead of debating the merits of European fiscal harmonization; and a swifter shift of investments away from the classic industries to information technology, a sector for which the European Commission has most recently calculated a demand for skilled labor equal to 1.5 % of the current EU work force.

#### ***IV. Trade tensions do not really matter***

It is obvious, therefore, that the problem or what one could describe as the temporary breakdown in communication in the transatlantic relationship does not really stem from specific trade differences. Apart from the fact that these disputed areas amount to no more than 2 % of the total transatlantic trade volume, it is generally possible to negotiate compromises.<sup>35</sup> Commercial disputes about beef, bananas, GMOs, or foreign sales corporations have often bolstered the impression that the U.S. and the EU are fated to economic warfare. As a matter of fact, sometimes they threaten to undermine the increasingly vital relationship, and there are warnings that U.S. retaliatory measures against European import restrictions and European threats to retaliate against U.S. export subsidies worth several billion dollars could lead to a deeper rift in that relationship.<sup>36</sup> A U.S. law granting a \$4 billion tax break to domestic exporters topped the list in 2001. The EU complained that the law – which grants exporters tax-free profits from goods sold through off-shore companies known as foreign sales corporations – amounted to an illegal export subsidy because it provided an unfair competitive advantage to U.S. exporters. A WTO dispute panel agreed, prompting Congress to reduce the tax breaks. The EU complained that the new version of the

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<sup>35</sup> Blinken, op. cit., p. 46.

<sup>36</sup> Fred Bergsten, America's two-front conflict, in: Foreign Affairs, 80, 2 (March/April 2001), p. 17.



law failed to resolve the problem. Once again, the WTO panel finally agreed with the European view in August 2002, enabling the EU to impose up to \$4 billion in punitive duties on U.S. imports.<sup>37</sup> Nevertheless, \$4 billion will not be enough to seriously disrupt U.S. exports to Europe, which totaled more than \$150 billion in recent years. In other words, it is rather doubtful that these disputes could ever threaten the overall relationship.

Transatlantic mergers are another potential source of friction. Until recently, such activity was dominated by American firms, prompting fears of an American takeover of European businesses. But with the surge in bilateral investments, transatlantic mergers have boomed in recent years, and the latest buyouts have gone both ways. For instance, French media giant Vivendi Universal SA purchased U.S. publisher Houghton-Mifflin Co., and Deutsche Telekom AG bought out VoiceStream Wireless Corp., a U.S. mobile telephone company.

Another case of conflict was General Electric's Co's proposed acquisition of Honeywell International, another American industrial giant. U.S. regulators approved the \$45 billion deal, but EU regulators rejected it out of concern that the combined business would have too much power in the market for jet engines and other aviation products.<sup>38</sup> Both sides have started a dialogue over antitrust policy and practice to promote what the Bush administration called „soft convergence“ among national approaches. In carrying out this dialogue, Washington must recognize two key points. First, the conflicts between U.S. and EU antitrust law are not fundamentally about the protection of national interests; in many cases EU antitrust law has in fact hurt many European firms that have found deals blocked and consumer-friendly business practices condemned. Second, the Commission's competition directorate under commissioner Monti has been a progressive force in the EU, promoting the development of free markets and helping to dismantle cartels and nationalistic practices that restrain competition. Monti has kept European politics out of the decision-making and has pushed hard for competitive European markets. The EU today is a more open market for European and American companies because of Brussel's increasingly clear commitment to a more open world trading system. It has realized that internal European trade is not enough to boost both European economic growth as well as the enhanced economic strength and

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<sup>37</sup> Paul Blustein, US Loses Trade Case to Europe, in: The Washington Post, June 23, 2001; FAZ, August 31, 2002.

<sup>38</sup> William Drozdiak, EU Official Decries Bush effort on GE-Honeywell, in: The Washington Post, June 19, 2001.

political influence of European firms with global ambitions.<sup>39</sup> And of course the EU also claims the right to regulate competition within its borders just as the U.S. does - a point many critics missed during the GE-Honeywell dispute.<sup>40</sup>

There is no doubt that transatlantic divergences in antitrust enforcement are likely to become more persistent. The U.S. approach to absent price fixing or other corporate practices that clearly harm consumers is to use competition as a means to protect the public interest, even if that means a dominant company emerges from this fray. In the EU there is no such confidence in this method, but as long as European regulators look warily at competition, the ability of companies to consummate mergers or to enter new markets remains compromised.

Even more difficult to solve are issues concerning genetically engineered products, hormone-treated meat, or specific standards in the e-commerce sector, since they touch upon transatlantic value differences. But even in these cases solutions can be found and, apart from that, recent polls show that American and European views are beginning to converge. More and more Americans support mandatory labeling; the majority would avoid bio-engineered foods if labeled as such. In other words, „Europeans are winning the argument on GMOs and winning American converts“.<sup>41</sup>

After all, despite frequent disputes, the two great economic powers have begun to fashion a common strategy based on a shared interest in open trade and respect for each other's strengths and constraints. Even when one of the partners stumbles, as the U.S. has done recently by imposing steel import tariffs, the other picks up the banner of global leadership and challenges the other to return to its open-trade commitment. This „game“ follows the same pattern of domestic policy logic on both sides: free trade is praised rhetorically but is in fact constrained from time to time.

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<sup>39</sup> David Gompert, The EU on the World stage, in: Internationale Politik (Transatlantic edition), 3, 2 (Summer 2002), pp. 3-9 (4).

<sup>40</sup> David Evans, The new Trustbusters: Brussels and Washington may part ways, in: Foreign Affairs, 81, 1 (January/February 2002), pp. 14-20.

<sup>41</sup> Blinken, op. cit., p. 39.

## *V. Globalization - two points of view*

The real gulf then is in the divergent perceptions of the opportunities provided by globalization and of the options for shaping the globalization process. These perceptions are tightly enmeshed with the different concepts and interpretations of society on both sides of the Atlantic. Europe, in spite of all the differences among EU member states, tends to view globalization as a threat to the achievements of society based on the nation-state. By contrast, Americans have a weak concept of the state. Society is viewed as a social dynamic unit capable of fulfilling its function independently of the state.<sup>42</sup>

Europeans deplore the loss of control over their businesses in the course of globalization and the progressive constraint on their ability to raise taxes and to shape their social systems. There are growing fears among people that policies in the age of globalization benefit big companies operating worldwide instead of average citizens who lose their comparative advantage when those companies build advanced factories in low-wage countries, making them as productive as those at home. Environmentalists argue that elitist trade and economic bodies make undemocratic decisions that undermine national sovereignty on environmental regulation. Unions charge that unfettered trade allows unfair competition from countries that lack European labor standards; that people have lost their jobs due to imports or production shifts abroad; and that workers face pay-cut demands from employers, who threaten to export jobs.<sup>43</sup>

Since the early 1990s the U.S., on the other hand, has quickly adapted to the reign of globally active corporations, international financial markets, and international competition in the fiscal, social, and business environment arenas. Washington wants to keep the capital markets open because the American economy with its low domestic savings rate is more dependent on foreign capital for its debt payments than is the European one. Obversely, Europeans try to buffer the disparities and imbalances of the markets by regulating them.

Politics, business, markets, and the stock exchange in the U.S. are oriented to the future through investments in key technologies and have thus become the real engine for growth,

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<sup>42</sup> John Rielly (ed.), *American Public Opinion and US Foreign Policy 1999*, Wakegan, Ill. (Chicago Council on Foreign Relations), 1999, p. 19.

<sup>43</sup> Georg Vobruba, *Integration und Erweiterung. Europa im Globalisierungsdilemma*, Wien: Passagen-Verlag 2002, pp. 41-64.

innovation, advancement in productivity, and the reduction in the national debt and unemployment. The widespread notion is that open borders have allowed new ideas and technology to flow freely around the globe, fueling productivity growth and helping U.S. companies to become more competitive than they have been in decades; that global competition and cheap imports have helped to keep a tight lid on consumer prices; that export jobs pay more than other jobs; and that unfettered capital flows give the U.S. access to foreign investment and keep interest rates low. As a result, many U.S. families are doing better than ever. What is more, polls have shown for years that a solid majority of Americans believe that open borders and free trade are good for the economy.<sup>44</sup>

On the continent, by contrast, there is only an incipient understanding that speed has replaced size and tradition as entrepreneurial virtues. While the U.S. deems the European social structure incompatible with modern economic concepts, the Europeans view their social safety nets and the egalitarian element in the educational system (whatever its other flaws) as indispensable democratic achievements and, at least in principle, also as productive factors, not as a burden. Americans seek equal opportunity, which risks leaving some behind. Europeans preach equal results, which promises greater equality – but at the bottom, not at the top. In the 1990s, America adjusted to economic change by allowing inequality to rise, Europe by accepting higher unemployment.

Due to this transatlantic difference in economic philosophy the American and European social systems differ from each other in two fundamental aspects.

First, in the U.S. model social benefits and people's expectations towards the role of the state in social welfare are low. In most EU member states it is just the opposite. Their welfare systems are characterized by high levels of spending (especially on transfers), insurance-based social programs, high inter-generational solidarity with modest to high vertical redistribution, considerable employment protection and benefits for the core workforce, good social investment in human and social infrastructure, and moderate to low levels of poverty and inequality.<sup>45</sup> In addition, the way social policy is financed in many EU member states undermines their international competitiveness, especially in comparison to the U.S. – as long

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<sup>44</sup> Aaron Bernstein, Backlash. Behind the Anxiety over Globalization, in: Business Week, 3678 (April 24, 2000), p. 40.

<sup>45</sup> Ian Gough, Social aspects of the European Model and its Economic consequences, in: Wolfgang Beck et al. (des.), The Social Quality of Europe, Bristol: The Policy Press 1998, p. 90.

as European firms are not compared with U.S. firms with high internal company social benefits.

The situation is even worse today as the average productivity in Europe, which used to compensate for this disadvantage, has gradually decreased over the years. The U.S. has a much more integrated social and economic market than the EU. Europeans are much more dependent on a reasonable balance between wage costs per item and productivity. Empirical evidence indicates that roughly two-thirds of the gap in the EU GDP per capita relative to the U.S. can be attributed to a lower labor utilization while a lower average labor productivity accounts for the remaining third.<sup>46</sup> Growth in labor productivity in turn can be attributed to capital deepening (changes in the capital/labor ratio) and technical progress, as measured by total factor productivity. In the late 1990s, both factors of labor productivity growth improved more in the U.S. than in the EU. Any sustained improvement in standards of living, the ultimate goal of economic policy, thus requires substantive progress in production efficiency brought about by improvements in the stock of capital, in form of new investment, and by technological progress. In other words, the economy must realize high growth in productivity.

Second, generally speaking the U.S. model is short-term oriented whereas the European model, due to its institutional and cultural prerequisites, is long-term oriented. The stock market as the main source for management capital reinforces this characteristic feature in the U.S. model. In the last two decades the largest borrowers in the U.S. „ended relationships with banks or other financial intermediaries that previously were the major source of external finance and borrowed directly through the financial markets“.<sup>47</sup> Both social systems have a certain ambivalence: In the U.S. model there is a need to adjust to diverse demands of social change rather quickly. There is much greater functional flexibility, particularly in the labour market involving such aspects as multi-skilling, job rotation, retraining and upgrading.<sup>48</sup> Current successes, however, often block proposals for a sustained reform of the system in general. The EU system, on the other hand, offers a broader range of options. Because of the support of a broader social security net, there is either a greater desire for long-term planning

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<sup>46</sup> European Commission, Economic growth in the EU: Is a „New“ Pattern Emerging?, Chapter 3 in the EU Economy 2000 Review, European Economy (71), 2000.

<sup>47</sup> Eileen Appelbaum, Peter Berg, Financial Market Constraints and Business Strategy in the USA, in: Jonathan Michie, John Grieve Smith (eds.), Creating Industrial Capacity. Towards Full Employment, Oxford: Oxford University Press 1996, p. 200.

<sup>48</sup> Gerrit van Kooten, Social Exclusion and the Flexibility of Labour, in: Paul Littlewood et al. (eds.), Problems and Paradigms, Aldershot: Ashgate 1999, p. 50.

or a greater resistance to any social changes.<sup>49</sup> In other words, the European model includes the ambivalence between greater future success and momentary stagnation.

For Europeans the dilemma remains that, due to the constant demands on their social systems, the socio-political compensation of potential losers of globalization is much more difficult than in the U.S. Because of its greater efficiency, the U.S. is better prepared to meet the socio-political requirements of globalization as well. Regarding the U.S. system, one could assume that there is no need for any socio-political compensation of the globalization process. Empirically, however, this conclusion is not tenable. In the preliminary stages of the NAFTA negotiations, for example, financial compensation payments to various interest groups with a substantial veto power were necessary as well.<sup>50</sup> Thus, the most decisive question in this context is, first, are there any mechanisms in which the gainers can compensate the losers and, secondly, what instruments are at the disposal of the state to compensate the losers?<sup>51</sup>

Another cause for conflict is the U.S. foreign economic approach. Europeans charge that the U.S. talks up international norms and treaties, whereas Americans are concerned about abdicating sovereignty to supranational institutions and organizations. The rules governing the global economy emerge from multilateral talks that reflect the bargaining power of the negotiating countries. This power in turn broadly corresponds to the size of each country's economy. The larger the economy, the greater the ability to shape those rules. Thus the U.S., more than any other country, has great leverage in determining the content of the rules and procedures that have accompanied globalization. Its voice is dominant in multilateral organizations such as the UN, the World Bank and the International Monetary Fund, and it was the most powerful influence in shaping the content of the rules that the WTO enforces.

The U.S. position with regard to the shape of the global economy has been remarkably consistent over the years. John Williamson is credited with first labeling as the „Washington consensus“ the package of policies which the United States endorsed in trade negotiations and insisted upon in the councils of the World Bank and the IMF. With the Washington

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<sup>49</sup> Robert Goodin et. al., *The Real Worlds of Welfare Capitalism*, Cambridge: Cambridge University Press 1999, pp. 134 ff.

<sup>50</sup> Christoph Scherrer, *Globalisierung wider Willen?*, Berlin: Sigma 1999.

<sup>51</sup> Victor Bulmer-Thomas, Nikki Craske, Monica Serrano, *Who will benefit?*, in: Bulmer-Thomas, Craske, Serrano (eds.), *Mexico and the North Atlantic Free Trade Agreement. Who will benefit?*, Basingstoke: Macmillan 1994, p. 208.

consensus, the United States unreservedly insisted on unregulated markets and reduced governmental economic activity. In Williamson's formulation, the Washington consensus consists of ten elements, very different to the EU's policy:

- fiscal discipline in government spending (as opposed to comparatively high public spending in the EU);
- a redirection of public expenditure away from subsidies;
- a reduction of marginal tax rates;
- decontrolling interest rates;
- moving away from fixed exchange rates (like in the EU) to more flexible, market-determined ones;
- trade liberalization;
- liberalizing foreign direct investment inflows - „dollarization“ - (as opposed to controlled capital mobility, a position favored by the EU);
- privatization of public enterprises;
- deregulation of output markets;
- and securing private property rights.<sup>52</sup>

In the EU the notion prevails that Washington's intention is to advance the role of markets at the expense of other social institutions. The exaggerated charge by European elites is that America, in an almost ideological campaign, has sold its soul to savage capitalism at the expense of the poor. In providing a high level of freedom to market participants – most particularly to multinational corporations and financial institutions – it clearly reflects the preferences of those firms themselves.

In some respects, this consensus has worked well. In the case of the „four tigers“ – Hong Kong, Singapore, Taiwan, and South Korea – the deregulation of their economies, their export-orientedness, and the opening up to global markets improved the living standards dramatically. Policies to free FDI seemed to have helped at least those countries to accelerate economic growth for a long time. On the other hand, however, the liberalization of trade was accompanied by a reduction in the government's role, even in those areas where at least some regulation was extremely important. This weakness was particularly dramatic in the case of

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<sup>52</sup> John Williamson, What should the Bank think about the Washington Consensus?. Institute for International Economics. Available at [www.iie.com/TESTMONY/Bankwc.htm](http://www.iie.com/TESTMONY/Bankwc.htm).

labor and financial markets, where structural deficits became increasingly obvious during the Asian crisis.

Nevertheless, this crisis was not exclusively the result of huge capital flows from outside, especially from the U.S., but of several other, internal factors. It uncovered severe political deficits in these countries: the lack of rule of law; corruption and nepotism; state intervention; cutting society off from politics. And it had something to do with structural deficits such as the weak financial and banking systems, the lack of transparency with regard to companies' liquidity, increased short-term borrowing as a result of the currency peg, the tendency to indebtedness, and exclusive relying on an export-driven economic growth.<sup>53</sup>

## ***VI. Consequences for transatlantic competition***

What is the impact of these differences on the transatlantic economic community? There is no question that Europe's economy is undergoing structural change and is engaged in a process of catching-up. In other words, Europeans are coming around to America's way of doing business:

- Americans are still leading the online-revolution but Nokia, Ericsson, and Siemens meanwhile provide two thirds of all cell phones;
- German and European companies dominate production and process engineering. Germany has a 40% share in the world market in the industrial laser sector;
- Japanese and German companies are ahead of American competitors in the field of semiconductor materials and production sets;
- France, the world's fourth leading exporter, has comparative advantages in telecommunications, transportation, and aerospace;
- European multinational corporations such as Vivendi Universal and Bertelsmann are making their mark in America. One third of the 100 largest companies are located in the U.S., but companies such Wal-Mart, General Motors or Time Warner have difficulties gaining a foothold beyond the U.S. market. The U.S. has a 12 % share in world exports, Europe 16 %.

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<sup>53</sup> Paul Krugman, What happened to Asia?, 1998. <http://web.mit.edu/krugman/www/DISINTER.html> (28.8.2002).



The question is whether this economic change is accompanied by a corresponding policy change. At its Lisbon summit in 2000, the EU pushed its member states to adopt flexible labor markets and policies that support innovation, further privatization, and economic deregulation. Throughout Europe, in fact more and more countries and companies are following the U.S. lead in empowering shareholders, facilitating mergers and acquisitions, and providing greater corporate transparency. There is also no doubt that in Europe, America is almost everywhere and everything is American, from movies to music, from McDonald's to Microsoft. Products are American, and so are their vehicles: the English language and the Internet. The number of European workers, businesspeople, students, and tourists in America has reached record levels – every twelfth U.S. employee works for a business run by Europeans; conversely, American-owned businesses employ over 3 million Europeans. This would be quite a curious development if the „value gap“ were indeed as wide as critics often allege.

On the other hand, the long-lasting weakness of the euro and the current problems of the European economies are the most obvious signals that some European politicians are not yet keeping pace with the structural change and that the future of Europe depends not only on new resolve in the business world, but also on the will of European governments to effect change. According to the principle that „economics come before politics“, there is a reluctance to implement reform which can be measured by examining the nature of change in the following arenas:

- the continuing existence of an oppressive tax burden in many European countries;
- the invention of new forms of capital accumulation and the creation of a positive environment for investment;
- the subsidy mentality within the EU;
- reduction of the shortage of computer and biotechnology experts, either through half-hearted green-card solutions or by means of new immigration laws;
- insufficient investment in education in many EU member states;
- inflexible labor laws;
- and social systems that are threatened with collapse (and not only in Germany).<sup>54</sup>

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<sup>54</sup> David Purdy, Social Policy, in: Mike Artis, Frederick Nixon (eds.), *The Economics of the European Union*, Oxford 2001, pp. 240- 270.

Politicians may recoil from the notion that the „American model“ is becoming a reality in Europe. And of course, for Europeans it would be unthinkable to live with a distribution of income in which 20 % of society owns more than 50 % of the national income and the bottom 20 % must make do with only 3 % of the national income. Equally unacceptable for Europeans would be the lop-sided fixation on economic and financial measures of personal success. George Bush therefore raised at least tentative hopes for a gradual change of course in adopting a number of issues that have been typically „Democrat“ topics in the past, such as the strengthening of unemployment insurance, wider access to health insurance, or payment for prescription drugs through Medicare.<sup>55</sup>

Such a generalized argument, however, obscures the necessity for essential reforms which are needed to decisively improve the domestic European situation. If Europe wants to get even close to achieving the dynamic growth the U.S. has experienced in recent years, it needs stronger competition to attract industry to its side – and not further standardization of its economic, financial, and social policy. This, in turn, is the precondition for reducing the tensions in the transatlantic relationship. If Europe does not implement reforms, it will halt the very mechanism that set the structural reforms of the past few years in motion – that is, the competition among governments for mobile capital. All our experience tells us that markets view a currency as strong if it meets two criteria: first, prices in the currency area must be relatively stable over a long period of time; second, dynamic economic growth is favored by open or flexible markets and by favorable investment conditions which the state must create.

With the introduction of the Euro, the risk related to the exchange rate in cross-border direct investment within Europe has been removed forever. The resulting increased capital mobility in the Eurozone forces governments to improve conditions for businesses and for a mobile work force. This explains why some countries have now sharply lowered income and corporate taxes; why the deregulation of markets for goods is increasing; and why labor markets have become more flexible. The Euro increases the pressure for reform, and the Commission actively supports this process.<sup>56</sup>

Still, Americans should be sensitive to Europe's concerns. Also, both sides ought to acknowledge that, when it comes to globalization, the U.S. and Europe share certain anxieties

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<sup>55</sup> Präsident Bush's address to the Nation (January 29, 2002). Available at: <http://www.whitehouse.gov/news/releases/2002/01/20020129-11.html>.

and opportunities which outweigh their differences - not to mention that transatlantic economic relations are becoming more closely knit anyway. Europe as a whole (and not Asia, as is commonly thought) is the biggest investor, the biggest employer, and even – apart from Canada – the biggest trading partner of the U.S. – with a relatively balanced trade relationship. The American economy exports goods valued at \$150 billion and services worth \$90 billion to the EU, while the EU exports \$185 billion in goods and \$70 billion in services to the U.S. Mutual direct investments amounted to \$500 billion in EU investments in the U.S. and \$450 billion in U.S. investments in the EU. This corresponds to a share of 60% (for the EU) and almost 50% (for the U.S.) of the total foreign direct investment undertaken by each side.<sup>57</sup> Thus, both sides are extremely exposed to the process of globalization. Neither Europeans nor Americans can stop this process, but they can pace and shape it by forging trade agreements, strengthening social safety nets, protecting the environment, setting labor standards, investing more in education, and improving access to technology.

### ***VII. How to overcome the strategic divide – prospects for convergence***

A fundamental question for Americans and Europeans is whether they will use their prominence and their partnership to spread the benefits and share the burdens of globalization. First of all, that challenge can be met. Both sides need to acknowledge that they share certain problems and fears regarding globalization. Americans do worry about the downsides of globalization as well - as demonstrated by the 1999 WTO meeting in Seattle. Secondly, the weakness of the „Washington consensus“ in the case of labor and financial markets indicates that globalization requires a strengthened, not weakened, social safety net. Thirdly, Europe will not be able to avoid structural reforms that will lay the foundation for a further strengthening in the transatlantic relationship. In this context, Europe will also have to acknowledge that, far from diverging, the U.S. and the EU actually are converging culturally, economically, and with some effort, strategically.

The real question is how member states respond to the pressures of globalization and what scope exists to reform and protect the welfare state from erosion. Some governments have succeeded in maintaining relatively high levels of welfare spending, while at the same time

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<sup>56</sup> David Evans, The New Trust-Busters: Brussels and Washington May Part Ways, in: Foreign Affairs, 81, 1 (January/February 2002), pp. 14-20.

<sup>57</sup> William R. Smyser, The Core of the Global Economy, in: The World and I, 16, 4 (April 2001), pp. 26-31.

improving the performance of their economies and lowering unemployment. The Netherlands and Denmark experienced both high unemployment rates and fiscal deficits, and introduced tough deflationary packages. However, there was no assault on the legitimacy of the welfare state. Employers accepted the need for social protection, trade unions accepted the need for wage restraint, new patterns of working hours and reform of collective bargaining. This social partnership set in motion a process of policy innovation which, in the 1990s extended to social security and the labor market. Since then, employment rates have gone up, long-term unemployment has remained low (in Denmark it was halved from 12.1 % in 1993 to 5.5 % in 1997), and unemployed workers have not been marginalized. Above all, disposable incomes are much more fairly distributed than in the U.S. or in the UK, and there are excellent public services open to and used by most citizens, regardless of occupation and income.<sup>58</sup>

This proves that high social standards do not automatically lead to less economic success. As a matter of fact, a comparison of the Purchasing Power Parities-Index (PPP) and the Human Development Index (HDI) shows that economic success does not equal quality of life. Whereas the U.S. heads the list in economic success, it is far behind the top ten countries in the category of quality of life, which is led by Canada.<sup>59</sup>

Nevertheless, the often faulted income inequality in the U.S. is a more complicated story. As a matter of fact, the trend in the U.S. but also in other developed nations has been moving towards a wider income gap between the lowest- and the highest-paid workers. This gap has been primarily driven by differences in worker skills rather than by increased trade in a globalized world. Indeed, an information-based economy such as that of the U.S. certainly produces jobs which require more specialized and technical skills than a less developed economy. As a result, the gap between workers with College and University degrees and those with only high school diplomas has been increasing in the U.S.

International trade has certainly contributed something to this trend in the U.S., because in theory trade accelerates the transition towards industries that rely more heavily on highly-skilled labor. But evidence of a fully globalized U.S. economy is sparse. In 1999, the role of merchandise trade in U.S. GDP was only 2.5 percentage points higher than in 1880.<sup>60</sup> U.S.

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<sup>58</sup> Josef Schmid, *Wohlfahrtsstaaten im Vergleich*, Opladen 2002 (UTB 2220), chap. II.5, II.8 (pp. 121-136; 179-202).

<sup>59</sup> Ingomar Hauchler, Dirk Messner, Franz Nuscheler, *Globale Trends 2000*, Frankfurt 1999, pp. 466 ff.

<sup>60</sup> Robert M. Dunn, *Has the US Economy really been globalized?*, in: *The Washington Quarterly*, 24, 1 (Winter 2001), pp. 53-64 (56).

interest rates, both nominal and real, often differ from those in other major industrialized economies, and both fiscal and monetary policies remain independent. Moreover, flexible rates allow macroeconomic policies to differ more than was possible within any fixed system, thus increasing national economic independence in these matters.

A much more important issue is technological development in the industrialized world. Recent trends of job displacement in the U.S. have shown that three-quarters of Americans who lost their jobs in the latter half of the 1990s were working in sectors relatively insulated from trade. Even in the more trade-relevant manufacturing sector, technological change and rising productivity are the principal vehicles of labor-market change.<sup>61</sup> For this reason alone did the number of workers employed in the manufacturing sector in the U.S. remain stable in the 1990s, at a time when its output rose by an average of 3.8 % a year.<sup>62</sup>

Technology is also the main variable explaining changes in income inequality, a concern Europeans like to voice. As Daniel Griswold points out, quoting William Cline's study on the impact of trade on wages, technological change „is by far the largest identifiable contributor to the growth in income inequality“.<sup>63</sup> Apart from that, the rise in inequality may be unacceptable, but critics fail to note that the gap has grown at the top, not at the bottom. Family income and per capita income have increased for all Americans in recent years, admittedly after many years of stagnation.<sup>64</sup> The poverty rate has dropped to its lowest level since 1979, and federal tax collection reached its peak in 1999. The primary reason for this is that in the booming economy, the rich, who certainly absorbed most of the income growth, also paid the most into the system. Europeans should also keep in mind that poorer Americans were able to find relief from federal tax liability thanks to the earned income tax credit which former president Clinton greatly expanded. Finally, the much-disputed estate tax has been levied only against the top two percent of the population - although President Bush seeks to repeal it.

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<sup>61</sup> Daniel Griswold, Trade, Jobs, and Manufacturing: Why (Almost All) US Workers Should Welcome Imports, in: Cato Trade Briefing Paper, 6 (September 30, 1999), p. 11.

<sup>62</sup> Daniel Griswold, The Blessings and Challenges of Globalization, in: The World and I, 15, 9 (September 2000), p. 283.

<sup>63</sup> Griswold, The Blessings..., p. 283.

<sup>64</sup> Stephen Silvia, Globalisierung und der Anstieg der Unterschiede in der Einkommensverteilung in den USA, in: Antworten auf die Globalisierung. Deutschland und die USA. Eine Dokumentation des Ost-West-Kollegs, 29-31 March, 1999, Brühl 2000, pp. 36-41.

That said, there is another, often exaggerated European charge that Washington has sacrificed social policy to uncontrolled capitalism. In fact, U.S. unemployment rates are almost half that of the EU's figures, inflation is low, and home ownership is at its highest level in U.S. history. There are several good signs that America's economic success is having a deep socio-political impact on society as well. For example, in the 1990s the percentage of the federal budget dedicated to social spending, i.e. Social Security, Medicaid, and Medicare, increased from about 42 % to almost 50 %, soon topping 60 %.

Nevertheless, there remains a difference between European and American social policy. In the U.S., the failure to perceive the highly nuanced choices presented by globalization, and the ideological bias against European-style redistribution and intervention in the economy (rejecting the necessity for some form of compensation beyond the support for the needy), undermine the very legitimacy of thinking critically about these matters. It is especially in the field of foreign economic policy that the Washington consensus is most in need of reversal, and where the EU could and should play a central role as an opposite pole to the U.S.

First of all, globalization requires a certain amount of governmental intervention to strengthen the social safety net. Trade encourages nations to shift their production to those sectors in which they have a comparative advantage. Conversely, other sectors face their demise. The standard response to these inequities caused by globalization is to require the winners of this process to share some of their gains with those who lose through some form of compensation.<sup>65</sup> In domestic politics as well as within international organizations such as the IMF or the World Bank, programs such as job retraining, temporary income support or tax benefits for job relocation could reduce some burdens resulting from the changes caused by international market integration. Unfortunately there is still little room in Washington for this kind of social safety net, although in the aftermath of the Asian Crisis the IMF started to realize that measures need to be taken to meet certain internationally agreed targets in this regard. Such measures would not only involve debt relief (especially for the most heavily indebted, poorest countries) and the dismantling of barriers to poor countries' exports on a most-favored nation (MFN) basis, but also technical assistance, social safety nets to cushion

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<sup>65</sup> Gary Burtless, Robert Lawrence, Robert Litan, Robert Shapiro, *Globaphobia: Confronting Fears about Open Trade*, Washington, DC: Brookings Institution 1998, pp. 131-132.

the short-term impact of economic reforms on the vulnerable populations, and higher social spending, especially on health, education and retraining.<sup>66</sup>

The second area demanding reform concerns international capital flows. The movement into or out of markets has reached an unprecedented level, resulting in huge fluctuations in market prices. Since these transactions in overseas financial markets require the purchase of foreign currencies, capital movements result in correspondingly large fluctuations in exchange rates as well. The Asian crisis revealed the risks of uncontrolled capital movements, which left in their wake indebtedness and bankruptcy for both firms and banks, and stunted economic growth. If the right institutional setting to solve structural problems is not in place, „the dogma of liberalization“, as Joseph Stiglitz complains, „becomes an end in itself, not a means of achieving a better financial system.“<sup>67</sup>

The remedy would be, as Europeans argue, to make certain support systems available for dislocated workers and to constrain capital mobility. Most reflection on this issue revolves around policies to reduce speculative flows, such as a tax on transactions,<sup>68</sup> using the proceeds of the tax to help workers in poor countries adjust to new circumstances, which in turn could reduce protectionist measures on the part of their governments. Critics of the Tobin tax argue that financial markets will come up with innovative ways to avoid it, and that there is no chance for a global consensus on this issue anyway. This may be true, yet it does not mean that such a tax is unwarranted. As Jay Mandle put it, „avoidance of the lost production caused by financial panics would more than compensate for whatever reduction in investment might occur because of constrained short-term capital flows.“<sup>69</sup> Apart from that, there is simply no excuse for capitulating and surrendering the public interest to the dictates of the market.

In the wake of capitalism's biggest crisis since the trustbuster era, America is thinking about how to restore the public's faith in the system.<sup>70</sup> The crisis is but one manifestation of a massive problem in American politics: the power of big business and private wealth to shape the agenda and outcome of policy debates. U.S. economic policies excessively favor

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<sup>66</sup> Eduardo Aninat, Surmounting the Challenges of Globalization, in: Finance and Development. A Quarterly Magazine of the IMF, 39, 1 (March 2002), pp. 4-7.

<sup>67</sup> Joseph Stiglitz, „More Instruments and Broader Goals: Moving Toward the Post-Washington Consensus“. World Institute for Development Economic Research Annual Lecture (January 7, 1998), p. 8. Available at: [www.iie.com/TESTMONY/Bankwc.htm](http://www.iie.com/TESTMONY/Bankwc.htm).

<sup>68</sup> Thomas Palley, The Tobin Tax Debate. Destabilizing Speculation and the Case for an International Currency Transactions Tax, in: Challenge, 44, 3 (May/June 2001), pp. 70-89.

<sup>69</sup> Jay Mandle, Reforming Globalization, in: Challenge, 44, 2 (March/April 2001), pp. 24-38 (35).

corporations, because of these companies' tremendous influence on the political process. This is why even the political elites have now started to call for law-making to be less dependent on the influence of the corporate and financial sectors.

The same goes for any reforms of the IMF, the World Bank, or the WTO. These organizations already address a very wide range of international economic issues, but there are certainly other issues not central to their mandates which are also pressing and need national and international attention. Washington, despite its overall market-oriented stance,<sup>71</sup> is beginning to accept that these issues need to include the environment, international migration, labor and human rights, and institution-building. And it has realized that it cannot control these organizations any longer, as it did until the Mexican peso crisis in 1994/95.

### *Conclusion*

Europeans will have to acknowledge that there is a need for certain structural reforms to lay the foundation for greater economic convergence. Also, that many of their often-repeated charges are exaggerated and involve risking a partnership which benefits both sides and which is crucial for the stability and prosperity of the world. The Europeans' motives may include the desire to diminish America's hegemonic role in the post Cold War era; the use of the U.S. as a scapegoat for domestic political gain (as in the recent German election campaign); or perhaps the fear that America's unchecked capitalism and unilateralism could somehow lead to further alienation in the transatlantic relationship. Like his predecessor, Bush has promised to support the EU's efforts concerning a European security and defense identity, and to consult closely with allies on missile defense. He has vowed not to withdraw troops unilaterally from the Balkans. Finally, he supports common efforts to reform international organizations like the IMF along more European lines.

On the other hand, Washington will need to change the tone and content of the public debate in the transatlantic relationship. The current tensions also reflect a dated view of a world order in which the U.S. was able to shape the global agenda according to its own ideas, thereby risking - as in the current debate on Washington's war against Iraq - becoming isolated from

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<sup>70</sup> How to fix Corporate Governance. Special Report, Business Week, 3781 (May 6, 2002), pp. 69-78.

<sup>71</sup> For this see the „Report of the International Financial Institutions Advisory Commission“ (Meltzer Commission), March 8, 2000. Available at: <http://www.phantom-x.gsia.cmu.edu/IFIAC/USMRPTDV.html>.



the rest of the world. In this context, the EU plays a central role as an opposite force to the U.S. The more Washington is to appear in the role of the sole super power, the more discipline it must impose upon itself in dealing with its partners. Progress in globalization needs to be combined with willingness to engage in more consultation with the European partners about this subject.

After all, for all its strength, the transatlantic relationship is in a transitional period in the age of globalization. Driven by the phenomena of a „hyperpower“ on the one hand, and a new identity forged by economic, political, and security integration on the other hand, American and European elites tend to focus more on their differences than on common values and interests which are taken for granted. But even today, the multiple affinities in this relationship far outweigh the differences. In the end, there is no alternative to the transatlantic partnership.