The International Spectator 3/2002

Transatlantic Trade and Monetary Relations: The Nature and Limits of Conflict

Alan W. Cafruny*

At the beginning of the 1990s, it appeared that a more equal transatlantic relationship was developing as a result of the end of the Cold War and the Maastricht Treaty on Economic and Political Union. Yet the ensuing decade confounded these expectations. The wars of Yugoslav dissolution exposed European political weakness and dependence on American power. While the liberalisation of global financial markets spurred high rates of growth and productivity in the United States, the monetary union demanded fiscal and monetary austerity and did not solve the problem of structural unemployment. The divergent economic trajectories of the United States and Europe served to widen the imbalance in military power and propel the Bush administration into what EU External Relations Commissioner Chris Patten has called "unilateralist overdrive". [1]

If the political and diplomatic relationship between Europe and the United States is now passing through a period of unprecedented conflict and uncertainty, the nature of the economic relationship is less clear, despite its centrality to transatlantic and global politics. There has been no shortage of disputes during the past decade. European import restrictions on beef and bananas have provoked American retaliation, and the EU has refused to

*Alan W. Cafruny is Henry Platt Bristol Professor and Chair, Department of Government, Hamilton College, Clinton, New York. This article was prepared for the conference "New International Challenges: Reassessing the Translatlantic Partnership", organised by the IAI in Rome on 19/20 July 2002 and sponsored by the German Marshall Fund of the United States, the Institute for Security Studies of the European Union and the US Embassy in Rome.

[1] *The Guardian*, 9 February 2002.

import genetically modified products. There are important unresolved conflicts over military procurement, subsidies for Boeing and the Airbus, and special treatment offered to US exporters under Foreign Sales Corporations (FSC) tax provisions. Europe continues to oppose sanctions against firms doing business in Cuba and Iran. The agreement reached in Doha in November 2001 on a new round of global trade talks signaled greater transatlantic cooperation, especially after the debacle of Seattle.[2] Yet, in 2002 new conflicts erupted which threatened to overshadow the achievement of Doha. In March, President Bush invoked Section 201 of the US Trade Act of 1974 and imposed tariffs of up to 30 percent on steel, provoking hostility from Europe (and elsewhere) and reinforcing a pattern of Japanese-European cooperation that was also evident in Seattle. Less than two months later, he signed an agricultural bill calling for massive subsidies designed to win back markets lost to the EU.

These trade disputes have led many observers to warn of looming US-European rivalry as well as acute dangers to the global trading system. Fred Bergsten has predicted that "[t]he United States and the EU are on the brink of a major trade and economic conflict".[3] EU Trade Commissioner Pascal Lamy has declared that "we are reaching a critical point as far as the prospects for world trade liberalisation and transatlantic relations go".[4] The apparent invincibility of the dollar may have muted concerns in Washington and Wall Street about the long-range implications of the euro, but if America's corporate scandals continue to diminish confidence in the dollar these concerns might resurface.

This article assesses the nature and extent of transatlantic economic conflict. The first two sections examine, respectively, steel and agriculture, the two most important areas of tension. Notwithstanding the assumption of crisis that typically informs the analysis of each sector, there is little evidence that disputes portend growing transatlantic economic rivalry or that free trade is threatened. The level of transatlantic conflict has increased, but the present phase of economic relations is no more contentious than in the past. The third section addresses the potential for transatlantic monetary conflict. While the decline of the dollar would dampen protectionist sentiments in the United States, it might also generate increasing concerns about European Economic and Monetary Union (EMU). However, the euro has several structural features that will limit the extent to which it can challenge the dollar. The significance of transatlantic economic conflicts derives not from

[2] P. Guerrieri, "The Shock of 11 September and the Doha Development Round", *The International Spectator*, vol. 37, no. 1, 2002.

[3] C. F. Bergsten, "America's Two-Front Economic Conflict", *Foreign Affairs*, March/April 2001.

[4] *The Times* (London), 21 May 2002.

growing trade or monetary rivalry but rather from the impact of subsidies and protectionist policies in both the United States and Europe on developing countries.

The United States and the global steel market

Although the global steel industry has been contracting for a quarter century, surplus capacity has nevertheless been estimated at 35 percent. In 1974, total employment among major producers was 2.4 million; by 2000 it had declined to less than 900,000.[5] Most steel producers have relied on massive financial support from the state; European and North American producers have also received substantial protection. One third of anti-dumping cases before the WTO have concerned steel.

The United States is the third largest producer of steel, but the largest market for global steel exports, which account for approximately one third of US steel consumption. During the late 1990s' Asian financial crisis, Russia, South Korea and China increased their exports to the US, resulting in a rash of anti-dumping actions and increased protection, especially against Russian and former Soviet steel producers. Since the 2000 election, 21 companies have entered bankruptcy, including LTV and Bethlehem Steel. In 2001, steel production in the United States contracted by 14 percent. One of the problems for US steel companies is the high "legacy costs" of retirement benefits. In contrast to most European countries, where these costs are socialised, health care and retirement pensions are bound to firms and employment. The health and pension benefits of 600,000 retirees and family members are thus dependent on the actions of the federal government.[6]

Throughout 2001, discussions were held under OECD auspices on the formation of what would have amounted to a global steel cartel. In December 2001, plans for modest reductions in capacity (albeit non-binding) were agreed upon, but in any case US policies rendered these discussions moot. In June 2001, President Bush instructed the US International Trade Commission (ITC) to investigate under Section 201 authority whether steel imports were "a substantial cause of serious injury or threat of serious injury". In October, the ITC decided that US manufacturers in 16 of 33 steel products were injured. During this time, considerable momentum was building in the US Congress for the Steel Revitalization Act (HR 808) which generated substantial bipartisan support in the House but

[5] American Iron and Steel Institute (AISI), *Selected Steel Industry Data* <http://www.steel.org>, 11 December 2001.

[6] G. C. Hufbauer and B. Goodrich, "Time for a Grand Bargain in Steel?" *International Economics Policy Briefs* (Washington: Institute of International Economics, January 2002).

which would impose quotas and contradict WTO provisions.

The Bush administration's decision to impose tariffs on steel was motivated by a number of specific objectives, including the desire to appease Republican states prior to the 2002 and 2004 elections, to obtain Trade Promotion Authority (TPA) from Congress, to avoid passage of the Steel Revitalization Act which clearly violated WTO rules, and to use the threat of tariffs as a means of negotiating the destruction of surplus capacity in Russia, Ukraine and Brazil. Given the substantial legacy costs, which represent a severe comparative disadvantage for US industry, it is not certain that the administration's action will eventually be ruled out of order by the WTO. In any case, the decision is not linked to a coherent industrial strategy for steel and US producers have not previously used tariffs to develop a long-range recovery strategy. Although comparatively high labour costs are a factor in the loss of US competitiveness, steel has ultimately fallen victim to a foreign economic policy based on an overvalued dollar and IMF-mandated export-led development policies.

The steel dispute will not be resolved until the summer of 2003 when it has passed through the WTO adjudication procedure. In response to US policy, most other producers have increased their own protection. Although the EU has threatened to establish retaliatory tariffs on a list of products targeting Republican-held seats in forthcoming House and Senate races, the United States has granted significant exemptions to European firms, thereby containing the conflict. But the global industry appears to be experiencing further fragmentation. Although US producers have benefited greatly from tariffs, higher steel prices will hurt the real economy. The main victims – and immediate targets of US policy – are the largest net exporters, including Japan, Russia, Ukraine, South Korea and Brazil.

US agricultural policy: mercantilism not liberalism

In May 2002, President Bush signed a farm bill which will provide up to $180 billion in subsidies to farmers over the next decade. The bill renounces the commitment in principle to market mechanisms made in the farm bill of 1996 which was pushed through the House and Senate by Republicans (with strong bipartisan support) and signed by President Clinton. It has provoked serious tensions with the EU as well as the rest of the world.

Despite persistent skirmishing with Western Europe over various agricultural commodities, for the first quarter century after World War II the United States minimised the scope of transatlantic conflict by declining to mobilise its substantial comparative advantage, while allowing Europe to benefit from policies that had been developed during the New Deal. At that time American policymakers had diagnosed the problem of agriculture as one of chronic overproduction and not international barriers to trade. The federal government established agriculture programs designed to limit exports and provide price supports for farmers. Hence the central element of American policy until the 1970s was the reduction of exports, maintenance of income levels, and crop reduction.

During the 1970s, international food markets became increasingly unstable, subject to large price fluctuations, subsidy wars and a decrease in food aid. At the centre of this instability was the United States' decision to abandon the New Deal emphasis on crop reduction and deploy its underlying "green power" as it began to experience trade deficits.[7] In 1972, the United States liquidated half its grain stocks in order to sell wheat to the USSR. When exports of soybeans were temporarily halted in 1973, the world grain market became increasingly politicised, and many countries began to adopt self-sufficiency. However, spurred by a depreciating dollar, US grain exports grew from $7.7 billion in 1971 to $44 billion in 1980 (by which time over a third of American cropland was producing for exports) and to $54 billion in 1998. By 2000, US agriculture had become twice as dependent on international markets as the US economy as a whole.

Since the 1970s, the key US farm bills – although often couched in terms of free trade – have all sought to promote exports. The 1985 Farm Bill, for example, reduced support prices for grain, cotton and soybeans, but established an Export Enhancement Program (EPE). By providing substantial export subsidies designed to win back markets lost to the EU, the EPE sought to increase the burden of the European Community's Common Agricultural Policy (CAP), drive a wedge between the UK and France and thereby pressure France to reduce export subsidies in the context of the GATT.[8] The Federal Agricultural Improvement and Reform Act (FAIR) of 1996 (the "freedom to farm" act) was widely celebrated as a means of promoting the free market because it sought to establish a declining scale of "transition payments" in place of traditional subsidies and thereby de-link support payments from crop production decisions. In fact, FAIR came at a time of record high prices which made such reductions possible. Even more important, it contained clauses allowing Congress to increase subsidies when prices fell. Supplemental appropriations between 1998 and 2001 added more than $30

[7] A. Revel and C. Riboud, *American Green Power* (Baltimore: Johns Hopkins University Press, 1986). See also A. W. Cafruny, "Economic Conflicts and the Transformation of the Atlantic Order: The US, Europe, and the Liberalisation of Agriculture and Services" in Gill, S. (ed.) *Atlantic Relations: Beyond the Reagan Era* (London: St. Martin's Press, 1989).

[8] R. T. Libby, *Protecting Markets: US Policy and the World Grain Trade* (Ithaca: Cornell University Press, 1992).

billion in farm spending. Indeed, the FAIR Act may have made US farmers more dependent on federal money than during the Great Depression.[9]

The current farm bill institutionalises the *de facto* federal policies of the last five years. While allowing farmers to avoid fighting for supplemental appropriations each year it directs the US Department of Agriculture to "increase the value of US agricultural exports each year at a faster rate than the overall value of world export trade in agricultural products". Section 3210 states that a principal negotiating objective of the US is to ensure that "no other country can provide greater support, measured as a percentage of total agricultural production value, than the US does".

Western European agricultural policies after World War II were initially based on self-sufficiency. The Common Agricultural Policy was designed to ensure that output would rise; by reinforcing the power of farmers dependent on subsidies it set in motion powerful forces that would eventually push European production onto world markets. Transatlantic conflict intensified as the European market for American exports diminished and European exports began to penetrate markets which the United States also sought to dominate.

The CAP constitutes the "marriage contract" of the EU, and the EU will never give up the policy of food self-sufficiency. Unlike the US, however, the EU faces deep internal divisions over state support, especially in the context of enlargement. As a result of its own massive export subsidies and the strong dollar, EU agricultural exports surpassed those of the US by 1999 and the EU registered a positive trade balance in agricultural commodities with the US. At the same time, however, the US became substantially less dependent on exports to Europe as Mexico and Asia provided alternative outlets. Although the EU remains a key market for US exports, its relative importance has declined substantially, from 30 percent in 1982 to just 12 percent in 2000.[10] The expansion of alternative markets may help to explain why the US has been willing over the last few years to tolerate the reduction in exports to Europe resulting from the strong dollar, and why it is now seeking to retain these markets either by limiting EU supports or maintaining federal programs. The US negotiating strategy in the WTO – dramatic reduction of export subsidies and tariffs – reflects its underlying comparative advantage in agriculture but is unlikely to be acceptable to the EU.

US international farm policy clearly expresses a logic of sector-specific

[9] J. Earley, "Transatlantic Farm Conflicts Will Be Hard to Resolve", *European Affairs*, vol. 2, no. 3, 2001.

[10] Economic Research Service, "Briefing Room: European Union Trade", US Department of Agriculture, <www.ers.usda.gov/briefing/European Union/trade/html>.

politics, including the interests of agribusiness and its substantial clout in the House and Senate. During the last quarter century, however, the agro-export strategy has become increasingly central to America's overall foreign economic policy. Indeed, mercantilism in agriculture has developed in tandem with the erosion of America's industrial base. Agricultural exports are viewed as a "second best" strategy of compensating for trade deficits in manufactured goods. Agricultural production contributes approximately 15 percent of US GNP and is the largest export earner, whereas US federal farm outlays are less than 1 percent of the federal budget. Moreover, agricultural exports, which account for 20-30 percent of US agricultural output, have significant linkages to the non-farm sector.[11]

As with steel, transatlantic conflict imposes substantial costs on the rest of the world. The level of subsidy in the EU surpasses that provided for in the US farm bill. Each side accounts for roughly 20 percent of world agricultural exports; the US, Europe and Japan together spend approximately $350 billion on subsidies. The impact of subsidies and food exports on the developing world is well-documented.[12]

The global cotton and corn sectors exemplify the impact of subsidies on developing countries. The United States is the world's largest exporter of cotton. Partly as a result of more than $3 billion per year in subsidies, the US last year produced a record crop of 9.7 billion pounds; the resulting glut in world cotton has pushed prices down by 66 percent since 1995. The cost to West African countries, which are the third largest exporters of cotton and in which 2 million rural households are employed, is greater than the sum total of US and European foreign aid to the region. The recent US farm bill, moreover, calls for a 16 percent increase in subsidies to cotton growers. As for corn, the North American Free Trade Agreement (NAFTA) led Mexico to abolish its tariffs on corn, resulting in a sixteen-fold increase in heavily subsidised US exports, destroying local economies and precipitating large-scale movements of people from the countryside to cities south and north of the Rio Grande.[13]

[11] Libby, Protecting Markets: US Policy.

[12] See for example Oxfam's recent report "Rigged Rules and Double Standards: Trade, Globalisation, and the Fight Against Poverty" (London: Oxfam, 2002) <http://www.maketradefair.com>.

[13] For data on various commodities, see Economic Research Service, "Foreign Agricultural Trade of the United States" (FATUS), US Department of Agriculture, <www.ers.usda.gov/FATUS>. For the impact of cotton subsidies on West Africa, see R. Thurow and S. Kilman, "US Subsidies Create Cotton Glut that Hurts Foreign Cotton Farms", The Wall Sreet Journal, 26 June 2002; on the impact of NAFTA on Mexico, see T. Weiner, "Manzanillo Journal: In Corn's Cradle US Imports Bury Family Farms", The New York Times, 26 February 2002.

Trade and money in the transatlantic relationship

The cases of steel and agriculture do not signify the development of a more generalised protectionism or deepening transatlantic rivalry. To be sure, in both sectors US policy reflects the aggressive pursuit of self-interest, as well as the particular demands of powerful domestic constituencies. Within the context of trade deficits in excess of $400 billion, however, US polices in steel and agriculture are a means of compensating for continuing openness and de-industrialisation in the context of the extraordinary development of Atlantic economic integration since World War II. They do not indicate that the United States has abandoned its commitment to multilateral international trade policy.

Far from being interrupted since the breakdown of the Bretton Woods system, the process of transatlantic integration has accelerated dramatically over the last 25 years, and especially during the 1990s to constitute a relationship of "mature stability".[14] Between 1990 and 2001, two-way (merchandise and services) trade between the EU and the US increased from $273 billion to $537 billion.[15] The share of US imports from the EU remained steady (22 percent in 1990 and 21 percent in 2000), as did EU imports from the United States (16 percent in 1990 and 17 percent in 2000). The trend in foreign direct investment shows more evidence of Atlantic integration: In 1990, 58 percent of foreign investment controlled by EU firms went to the United States, increasing to 65 percent by 2000. During the same period approximately 25 percent of US FDI went to the EU. In 2000, two-way foreign direct investment stock was $1,376 billion. On the basis of these data, Hufbauer and Frederic Neumann liken the relationship between the United States and Europe to the "mature closeness of an older couple". [16]

There is little evidence that trade conflicts over steel and agriculture in themselves threaten the broader fabric of US-European economic relations. Historically, international monetary rivalry has been a more important cause of instability than protectionism in specific sectors.[17] Whereas US fears of

[14] G. C. Hufbauer and F. Neumann, "US-EU Trade and Investment: An American Perspective" (Washington: Institute for International Economics, 2002).

[15] US Bureau of Economic Analysis, "US International Transactions Accounts Data" (Washington, DC: Department of Commerce, 2002), <www.bea.gov/bea/international/bp_web/simple.cfm>.

[16] Hufbauer and Neumann, "US-EU Trade and Investment". The authors estimate that 5 percent of transatlantic merchandise trade is subject to complaints. However, they also cite studies which show that in a hypothetical "world of free trade" US imports of goods and services would increase by 14% while foreign direct investment flows would increase by 20%.

[17] S. Strange, "Protectionism and World Politics", *International Organization*, vol. 39, no. 2, 1985.

the EMU were muted by the strong dollar, it is possible that as the dollar weakens this could generate new conflicts and instability. The spate of recent financial scandals in the United States and resulting loss of confidence in corporate governance introduce a new element of unpredictability for the world economy.

Prior to the advent of EMU there appeared to be two possible sources of American concern. First, much commentary in the United States focused on the benefits of seignorage and, more generally, the possibility that the euro would become a rival to the dollar as a world currency.[18] A second source of concern for the United States has been the potential for EMU to serve as a more general vehicle for protectionism.[19]

Regarding the first concern, the euro faces numerous obstacles as a rival to the dollar. The scope of US financial power is illustrated by the dramatic increase in international bank and bond lending over the last two decades, more than three-quarters of which is denominated in dollars.[20] Despite the euro's successful launch, it appears unlikely that it will emerge as a challenger to the dollar in the short and medium term, or that the European Central Bank (ECB) views its mission in such terms. The continuing trend towards dollarisation increases the advantages from seignorage because it extends the role of the dollar as the key international source of credit and confers advantages on US exporters and importers. By the end of 2001, official or semi-official dollarisation had extended throughout much of Latin America. While the euro will undoubtedly displace the dollar in some areas, including Central and Eastern Europe, it is unlikely that the overall impact of the euro on the dollar's global role will be large enough to provoke serious transatlantic conflict.

There are also more general grounds for scepticism concerning the ability of the euro to challenge the dollar's role. It is unclear whether EMU's institutional and political foundations are strong enough to underwrite long-term stability. First, it is now widely recognised that the Stability and Growth Pact not only places pressure on the weaker economies, but also no

[18] K. Schuler, "Basics of Dollarization", Joint Economic Committee Staff Report (Washington: USGPO, 1999). On the more general concern about EMU see, for example, R. Mundell, "What the Euro Means for the Dollar and the International Monetary System", *Atlantic Economic Journal*, vol. 26, no. 3, 1998.

[19] M. Feldstein, "EMU and International Conflict," *Foreign Affairs*, November/December, 1997. Feldstein warned that "If EMU does come into existence…it will change the political character of Europe in ways that could lead to conflicts in Europe and confrontation with the United States." (p. 60).

[20] L. Seabrooke, *US Power in International Finance: The Victory of Dividends* (Basingstoke, Hampshire: Palgrave, 2001).

longer coincides with the interests of the stronger ones, including Germany. Since Germany signed the Maastricht Treaty in 1992, its unemployment rate has risen from 4.5 percent to 9 percent. Germany's growth rate for 2001 was the lowest of all 15 EU member states. Given the importance of the German economy to the EU as a whole, low growth impacts on the whole eurozone. If the Stability Pact were to be abandoned or reformulated in less restrictive ways, then international financial markets would rely on the ECB to retain the value of the euro. Yet, in contrast to the United States, the EU still has multiple central banks and no centralised fiscal policy. Whereas the power to set interest rates lies with the ECB, national finance ministers still nominally control exchange rate policy. Furthermore, budgetary targets have required steep cuts in public expenditure, but low growth and an aging population place pressure on national budgets. The virtual absence of a Union budget does not allow for the extensive redistributive policies needed to minimise uneven development. The deregulation of labour markets would not in itself be a sufficient means of counteracting uneven development within a single currency area, even if its scope were not still greatly constrained by the residual power of the trade unions.

The second concern about the euro in the US, that it would facilitate mercantilism, is only partially borne out by the performance of the ECB since the EMU's inception. Several factors account for the 25 percent decrease in the euro's value against the dollar, including lack of confidence in the underlying institutional base of the euro and comparatively slow European growth rates. Some observers have argued that the ECB pursued a policy of mercantilism, allowing the euro to depreciate in the interest of French and German exporters.[21] In any case, its decline did not provoke opposition from either the Clinton or Bush administrations, both of which have pursued a strong dollar against the objections of the manufacturing sector.

Conclusion

There is little evidence that the current disputes in steel and agriculture threaten to provoke a major rift in the transatlantic relationship or undermine the general tendency towards Atlantic economic integration. While the United States has sought to manage the consequences of a particular model of globalisation by imposing costs on trading partners, including at times the

[21] See especially M. Campanella, "Euro Weakness and the ECB Economic Governance: A Strategic Institutionalist Perspective" in Campanella, M. and Eijffinger, S. (eds), EU Economic Governance and Globalization (London: Edward Elgar, 2002). See also L. S. Talani, "The ECB Between Growth and Stability", unpublished manuscript, 2001.

EU, it has not abandoned multilateral norms and institutions in trade and monetary relations as it appears to be doing in political-military affairs. To be sure, the recent congressional granting of TPA by a polarised House and Senate illustrates diminished support for globalisation. However, given the large US trade deficits of recent years and the impact of plant closings on communities, it is perhaps surprising that congressional and popular resistance to free trade has not been greater.[22]

While transatlantic trade conflicts do not threaten the broader economic and monetary relationship, there are certainly no grounds for complacency. As the cases of steel and agriculture show, the problem of the global political economy is not a straightforward one of protectionism vs. free trade, but rather American and European policies of disguised mercantilism which impose massive costs on developing countries. At the same time, growing resistance to globalisation in the United States – most evident in the difficulty obtaining TPA – exposes the contradictions of an international economic model based on a strong dollar, structural adjustment programs requiring export-led growth, and America's role as "importer of last resort". There is a pressing need for the United States to reduce protectionism in steel, and to abide by WTO rules to negotiate the reduction in global capacity. But the reliance on protectionism also throws a spotlight on the absence of industrial policies, the limits of the federal Trade Adjustment Assistance Program, and the lack of alternative strategies for community reinvestment and development. As the social safety net erodes and government is "downsized", tariffs increasingly serve as a politically expedient path of least resistance to the destabilising effects of globalisation.

The problem of agriculture, in which Europe, Japan and the United States combine in a system that impedes Third World development, is even more acute than that of steel. Increasing subsidies in combination with IMF-mandated open market policies for developing countries contribute to an exodus from the countryside that resembles the enclosure movement of 17th and 18th century England and generates a host of new global problems including rapid urbanisation, environmental degradation, mass unemployment, and large cross-border migratory flows. At the same time, most of the benefits of farm programmes in the United States and Europe go to the

[22] The dollar appreciated by 30% in value against all other currencies between 1997 and 2001. Between August, 2000 and December 2001 the United States experienced a $140 billion drop in manufactured exports. The National Association of Manufacturers (NAM) estimates a loss of approximately 500,000 jobs resulting from the overvalued dollar. NAM, "Overvalued Dollar Puts Hundreds of Thousands Out of Work" <www.nam.org/docs/itia/24415_Dollar_Paper>.

largest farmers. US federal policies have not prevented the decline of family farming and the impoverishment of large sectors of rural America. The EU has initiated direct payments to farmers designed to break the link between support and production, and it is possible that the demands of enlargement and the declining corporate power of farmers may reduce subsidies.[23] However, the US farm bill will weaken the case for reform while the unwillingness to make commitments to Africa at the G-8 meeting in Canada in June 2002 shows that industrialised countries will not easily embrace changes in their agricultural policies.

[23] M. Hennis, "Europeanization and Globalization: The Missing Link", *Journal of Common Market Studies*, vol. 39, no. 5, 2001.