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THE YEAR 2004 IN PREVIEW: A YEAR OF TRANSITIONS

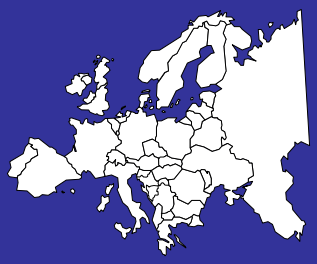
The start of a New Year is an invitation for reflection and forecasts. It is a moment of transition, when our sense of the past year shapes our views of the coming year. Ever since September 11, 2001, the New Year has been ushered in with a dose of anxiety—what new troubles may lie ahead, what further calamities will we face? In 2002, the scars of the attacks on the World Trade Center and the Pentagon were still open wounds aggravated by widespread concerns that beyond the war in Afghanistan we and others in the world faced a "new security normalcy" of some duration and unforeseen consequences. In 2003, the looming threat of war in Iraq cast a similar pall, though this time in the context of widening differences between the United States and Europe, as well as within Europe. In 2004, elections in Europe, as well as in the United States, will enable citizens to voice their satisfaction and concerns, while their leaders attempt to postpone their most difficult decisions until these voices have been heard.

As was the case in 2002 and 2003, the threat of terrorism looms large in 2004, and heads of state and government remain at the mercy of events they cannot truly control or fully deter. Where that threat will be felt cannot be predicted. But that it will be felt somewhere in 2004 is likely. And when terror strikes again, the consequences within each country on both sides of the Atlantic, as well as among them—within the EU or NATO—are likely to be of some signficance, for the much better or the much worse.

Leaving terror aside, the growing pains of enlargement will prove trying for all EU members, but even without enlargement, the EU is facing unprecedented challenges over the Stability and Growth Pact, which France and Germany have openly ignored, and its need for a new treaty, dubbed a "constitution," which the EU failed to adopt this past month after a bitter debate. All in all, the EU members have rarely been as divided on so many vital issues as they are today, and the two small countries, Ireland and Holland, which hold the two six-month presidencies scheduled for 2004, will play a major role in keeping the EU as one or allowing it to go "multispeed" at the expense of all.

All of this is to suggest that the transition to 2004 begins with a level of ambivalence unprecedented in recent years: the state of the (European) Union is troubling, and the condition of the (Atlantic) Alliance is troubled. Added to this ambivalence are fluid political conditions among many of the key countries within both the Alliance and the Union: elections in the U.S. and Spain (as well as, possibly, Poland), and also elections for the EU and further challenges to political leaders in the UK, France, Germany, and Italy. Even if limited to the "known knowns" of the coming agenda, 2004 will demand political leaders to show vision in their decisions and moderation in their criticism. This is not little to ask, but given the circumstances that continue to prevail 30 months after 9/11, it is not too much to expect either.— THE EDITOR

THE EUROPEAN UNION



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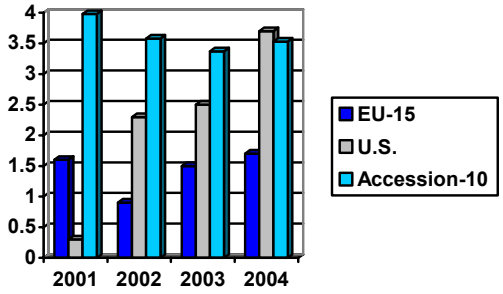
A Troubling Union

The year 2004 will dramatically influence and shape the future of European integration. The EU will grow from fifteen to twenty-five members. Member states will decide whether, and in what form, to ratify the constitutional treaty drawn up by the European Convention. The future of the Stability and Growth Pact, the underpinnings of monetary union, will be resolved in part by the recovery (or lack thereof) of the French and German economies. In these issues, the very foundation and identity of Europe, now and in the future, is at stake. What emerges at present, however, is an image of uncertainty, disunity, and discord within the Union: in 2004, serious and worrisome fractures threaten to split Europe.

A Union of 25

In a ceremony in Dublin, Ireland on May 1, the EU will officially complete its largest and most ambitious expansion ever, with the accession of ten new member states, including the three Baltic states (Estonia, Latvia, and Lithuania), five countries in the East (the Czech Republic, Hungary, Poland, Slovakia, and Slovenia), and the two islands of Malta and Cyprus. The attractiveness of EU membership has long been the political benefits of inclusion, in terms of legitimacy and stability. This continues to be the case. To many with still fresh memories of life within the Soviet Empire, Europe's enlargement to Central and Eastern Europe (CEE) is made imperative by the wrongs of history. The juxtaposition of EU enlargement with that of NATO (from 19 to 26 members) is no coincidence: now as in the Cold War, it is informally assumed that the European members of NATO have a right of first refusal for EU membership (with the notable exception of Turkey), while EU members have a right of first refusal for NATO membership as well. Yet, for this round of enlargement especially, the political factor cuts both ways: the period of adjustment and acceptance that await the new EU members will prove especially difficult this time, as a number of new members, and especially Poland, the largest among them, have moved at the center of various EU controversies to the resentment of some of their soon-to-be EU partners.

GDP PERCENTAGE GROWTH, 2001–2004
SOURCE: EUROPEAN COMMISSION



Even more so than political considerations, the economic advantages of integration have bound member states together and drawn others to seek membership in the EU. That being said, the addition of the new members poses a number of serious economic concerns and challenges. It will take several more years for the new members to join all of the features of the EU, such as the Schengen borders regime and the monetary union. Likewise, as was the case in the past, the effects of enlargement will be fully revealed only after a period of years. Nevertheless, in 2004 the European economy should begin to feel a real and immediate impact from enlargement.

First, although the combined economic weight of Central and Eastern Europe remains relatively small — all ten new members combined will raise the EU's GDP by a mere 5 percent — these economies have demonstrated relatively strong growth in the past year, 2 percent higher in aggregate than that of EU-15. As the CEE economies continue to develop, their potential for further growth is expected to remain strong, thereby giving a boost to the Eurozone's stagnating growth figures. Ideally, continued growth in the new members will eventually spill over and help to jumpstart economic growth in Western Europe, but that is no sure bet. What is more likely in the short term is a *de facto* rise in the EU's overall unemployment rate, as unemployment in all 10 new members averages around 15 percent, compared to the EU's current average of 8.3 percent.

Enlargement will also redirect the flow of wealth within the EU, as EU structural funds are reappropriated to the new members. As the EU budget currently stands, Poland would gain the most, with approximately 4.5 percent of its GDP in 2007–2013 coming from the EU, an influx of around €2000 per person. Spain stands to lose the most, the 0.8 percent of the Spanish GDP drawn from the EU dwindling to zero between 2008 and 2011. Germany's contribution to the EU budget is projected to grow by one-quarter in the coming decade, reaching €1350 per German. In France, fears abound that enlargement will transform their current EU budgetary advantages, especially with regard to agricultural subsidies, into a burdensome contribution well in excess of the current outlay of 0.2 percent of GDP. Although the EU budget for 2004 has

already been set, the situation sets up a fierce clash over future EU finances, starting in January when the European Commission begins the process of creating a financial framework for 2007–2013. The matter of national interests and the EU budget will be an increasing source of tension in the enlarged Union. Of particular interest will be the impact of the budget debate on two sets of special relationships within the EU: France and Germany on the one hand, but also Spain and Poland, which formed the main axis of discontent during the recent constitutional debate.

A Constitution for Europe?

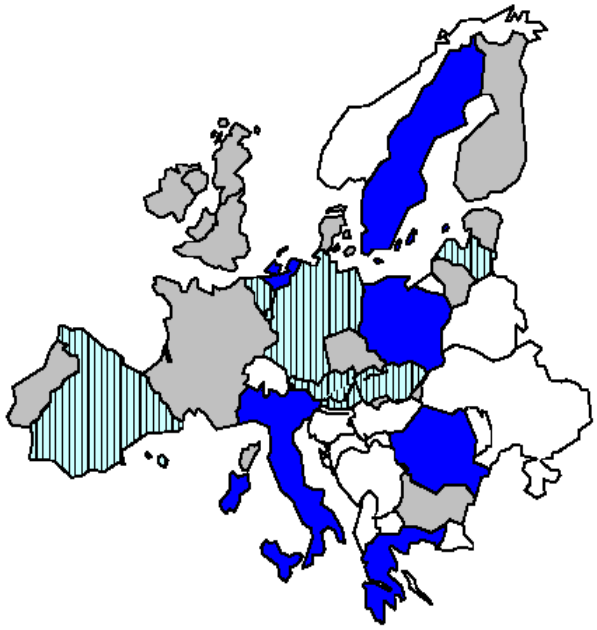
The Intergovernmental Conference (IGC) launched last October in Rome was designed to lead to the adoption by the 25 EU members (current and upcoming) of the constitutional treaty, drawn up at the European Convention presided by Valéry Giscard d'Estaing (*Euro-Focus, Europe's Constitutional Contentions,April 16, 2003*). Questions surrounding the document have had dramatic polarizing effects, especially on such issues as voting weight in the Council of Ministers, representation on the Commission, and the mention of Christianity in the text.

With the traditional engines of integration, France and Germany, standing firmly on the side of adopting the document as it stands, Poland and Spain have argued no less firmly on behalf of the provisions of the Treaty of Nice, adopted in December 2000. The resulting quarrel, exacerbated further by France and Germany's steamrolling of the Stability Pact issue (see below), derailed the December EU summit, during which Silvio Berlusconi had hoped to have the treaty approved by all heads of state and government, before ratification by all or most member states in 2004.

The most difficult issue remains the distribution of voting power in the Council of Ministers. Under the provisions of the Nice Treaty, Poland and Spain each have 27 votes in the Council, whereas France and Germany have 29 votes apiece. The constitutional treaty would make voting power in the Council proportional to population as well, requiring a double majority of half of the member states plus 60 percent of EU population to pass a measure. This adjustment would work to the benefit of France and Germany, which together represent 30 percent of EU population.

The failure of the IGC in December is a serious setback for advocates of the constitutional treaty. Responsibility for resolving the matter has been passed on to the Irish EU presidency, which began on January 1, 2004, with the next attempt at agreement thus scheduled for an EU summit that will take place in March. However, with general elections to be held in Spain at about that time, on the eve of enlargement scheduled to take place on May 1, and with European Parliament elections set for July (and hence, the replacement of European Commission president Romano Prodi), serious negotiations are unlikely to resume until the second half of 2004, under the Dutch EU presidency.

SUPPORT FOR A EUROPEAN CONSTITUTION



More than 69% (Cyprus*, Greece, Italy, Malta*, Netherlands, Poland, Romania, Sweden)
62-69% (Austria, Belgium, Germany, Hungary, Latvia, Luxembourg, Slovak Rep., Slovenia, Spain, Turkey*)
Less than 62% (Bulgaria, Czech Rep., Denmark, Estonia, Finland, France, Ireland, Lithuania, Portugal, U.K.)
* Not shown, Source: Eurobarometer 59, Spring 2003.

As it stands, the two camps have hardened their positions. French and German officials have repeated statements to the effect that they prefer no agreement to a flawed compromise, and there is little indication that Spain and Poland intend to compromise on their stance. Instead, warnings are ominous. German chancellor Gerhard Schröder has issued a not so subtle warning that acceptance or rejection of the constitutional treaty is linked to the future distribution of EU finances and Germany's contribution to the EU budget. Commission president Romano Prodi has implied that states that reject the constitution may be forced out of the EU entirely in order to avert the collapse of the community as a whole.

The inability to agree on the draft constitution has breathed new life into the idea of a "multispeed" or

"multitiered" European Union defined by differing levels of integration. In this scenario, those states most strongly supportive of integration, that is, those supportive of the constitutional treaty in its current form, would move ahead with deeper integration. France and Germany rank first among these states. Others, that do not wish to go "further faster," to use President Chirac's formula, could choose to integrate in selected fields only, while still others could opt out altogether. Although the multispeed idea is hardly new — it is currently in effect for the single currency, adopted by only 12 of the 15 current members — many of the staunchest proponents of European integration dread the concept of multispeed integration as incompatible with the overall goal of an "ever closer union."

Should the constitutional treaty be adopted nonetheless in 2004 (after elections in Spain weaken its current alliance with Poland), an additional potential danger lurks in the form of national referendums that would be held in many or most EU countries to ratify the document. Proponents of the referendums argue that only such explicit approval of European populations will impart legitimacy on the EU. As has been seen in the past, however, notably in the votes on the Maastricht Treaty in 1992, referendums can seriously complicate the integration process. Indeed, rejection in one national referendum, much less several, would have catastrophic consequences, not only for the constitutional treaty, but also, arguably, for the entire process of European integration. Thus far, the Czech Republic, Denmark, Ireland, Luxembourg, the Netherlands, Portugal, and Spain have already committed to holding national referendums. Although the use of referendums is constitutionally banned in Germany, the issue has been raised in France, where nearly three-fourths of the general public are said to be in favor of this procedure, which President Chirac is reportedly considering. The significance of France's decision cannot be overstated: Prime Minister Blair's adamant opposition to a referendum would be difficult to sustain if France and most other EU members were to hold one — and the likelihood of Britain voting for ratification in a referendum is, at best, not strong.

… now that the euro is a reality, the rules of the [Stability and Growth Pact] place unnecessarily difficult strictures on the members and, ironically, most of all…France and Germany …

The Stability and Growth Pact

As in the constitutional debate, the preeminence of national self-interest has greatly threatened the viability of the Stability and Growth Pact (SGP). As economic policy, the SGP may well have outlived its utility. It was born as a way to gauge the ability of member states to join the projected Eurozone. In this respect, it worked, as governments in Spain, Greece, Italy, and Portugal, used the carrot of euro membership to carry out difficult but needed structural reforms. But now that the euro is a reality, the rules of the SGP place unnecessarily difficult strictures on the members and, ironically, most of all the struggling engines of the Eurozone—France and Germany—which initiated these rules in the first place. Both of these countries are using public spending to kickstart economies weighted down by high unemployment and low growth. This approach, although necessary for domestic economic (and political) reasons, requires violating the 3 percent limit on budget deficits as a percentage of GDP.

Neither Germany nor France has tried to couch their violations of the Stability and Growth Pact in conciliatory terms. Recognizing that the alternative was even worse, the EU finance ministers let Germany and France off the hook by "suspending" the punishment process. Although economically this was the only conceivable decision, the ill will thus created by the Franco-German intransigence sharpened a double-edged sword. On the one hand, although the rest of the EU was essentially powerless to do anything but object, the bitterness and even anger thus caused among other member states that abide by the rules undermined the efficacy of the Franco-German leadership, particularly as it pushes for acceptance of the EU constitution.

The other "edge" of the sword is the possibility, albeit remote, of an economic crisis within the Eurozone. Although overly conservative and certainly in need of revision, the Stability and Growth Pact is not without its own rationale. Profligate spending by one or a few countries within a monetary union can be destabilizing. The path followed by Germany and France, then, inadvertently legitimizes the very type of fiscal irresponsibility that the SGP was trying to prevent in the first place. The threats are threefold:

- Excessive public spending will push up inflation and, in the largest EU countries like France and Germany, this condition could force the European Central Bank (ECB) to raise interest rates to a level higher than it might otherwise prefer or would be beneficial for the rest of the Eurozone members.
- The public debt issuances necessary to fund budget deficits could also overwhelm the market for private investment products. Such a situation

negatively impacts the ability of private firms to raise capital for the investments necessary to fund future growth.

- The worst-case scenario, and also the least likely, is a state that builds up so much debt that it ultimately would be unable to pay the interest and would be forced to default, which, at the very least, would cause a potentially severe depreciation of the euro and might even force a bailout, even though the EU is not required to do so. The likelihood of Germany or France experiencing a financial collapse of this size is extremely unlikely. But it could affect Central and Eastern European countries that insist on joining the EU too soon because they expect to be treated with the same leniency as their larger partners. By weakening the rules of the Stability and Growth Pact for Germany and France's benefit, the EU finance ministers have weakened the rules needed to guarantee the strict compliance of the new member states to prudent fiscal policy.

Notwithstanding such negative implications, France and Germany have gravely wounded the Stability and Growth Pact out of economic necessity. Admittedly, an alternative to the SGP is needed — merely letting it wither and die will eventually weaken the euro by exposing it to the prospect of gross fiscal mismanagement by member states. The most often suggested recommendation is a general loosening of the terms of the SGP, but within the existing general framework. This is in fact the best approach, as greater reforms, such as the creation of an independent committee with the power to change member states' fiscal policy, could not get the unanimous support needed to change the SGP. But a loosening of the rules might, particularly because it would maintain general fiscal guidelines intact that will be necessary in guiding the ten new enlargement states into the euro. Specifically, this approach could include a widening of the deficit limit to 5 percent, or an extension to five years the period over which excessive deficits could be tolerated. More meaningful would be the establishment of an enforceable rule requiring an average deficit balance of 0 percent over a 10-year rolling period. Such a policy is not dissimilar to current elements of the Stability and Growth Pact, but by making this rule the focus, it would allow European governments greater flexibility in managing fiscal policy. A new institution, in the form of an independent panel, would likely regulate such a new system. Operating on the basis of human judgment rather than fixed and arbitrary numbers, each particular situation could be taken into account separately, with an overall aim of sustaining the viability of the euro.

The Agenda Ahead

Ireland assumed the EU six-month presidency in January 2004. The failure to make a decision on the constitutional treaty has complicated the Irish agenda, as any possibility for constructive negotiations must be given priority, notwithstanding a widespread assumption that much of the effort needed to conclude negotiations toward the final adoption of a constitutional treaty will be assumed by the Dutch presidency during the second half of the year. Top priority must also be placed on enlargement to ensure that the process of adjustment goes smoothly. Irish officials have indicated they will be especially concerned with refocusing the EU on the Lisbon Strategy, which calls for the EU to be the world's most competitive knowledge-based economy by 2010. Competitiveness, economic dynamism, and growth will be promoted through an encouragement to relieve regulatory burdens on business and to invest in research and innovation.

Elections for the European Parliament (EP) will be held in June, but in numerous cases campaigning may start in earnest as early as February. The European People's Party and European Democrats hold the greatest number of seats (232) in the current EP of 626 representatives, followed by the Party of European Socialists, with 175 seats. The new parliament will include an additional 162 representatives from new member states. For some countries like Spain and France (see below), the European elections will be the second political test, coming after the spring's national and regional elections, respectively.

After the EP elections, the process of selecting a new European Commission will commence, to be completed by October 31, when the current Commission's five-year term of office expires. Speculation on a new Commission president has already begun, with the names of EP president Pat Cox, former Belgian prime minister Jean Luc Dehaene, former Finnish prime minister Paavo Lipponen, and Luxembourg's prime minister Jean-Claude Juncker mentioned most often. That all of them would come from smaller countries is no coincidence, as these countries need to be "pacified" in the context of the unfolding IGC. (In any case, the larger countries would rather bid for the European presidency that the constitutional draft envisions.) Once a new Commission president has been selected, he, along with the member state governments, will designate the rest of the commissioners for final approval by the European Parliament. The Commission

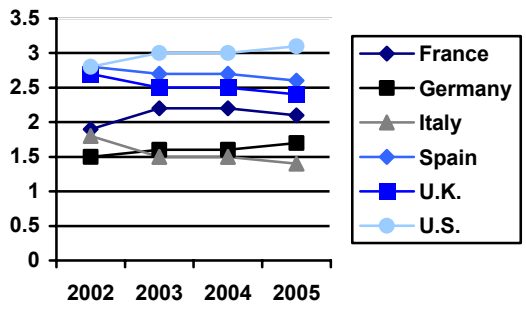
follows the same five-year cycle as the EP. As to Prodi, whose presidency of the Commission has been the source of much criticism, he is expected to return to Rome where he is anxious to challenge Berlusconi's leadership (although no new national election is expected this year). The timing of these elections in Europe, combined with the presidential elections in the United States, suggests that there is little chance of a serious attempt at relaunching significant trade negotiations.

Country Reports

Germany

The year 2004 will be pivotal for the Red-Green coalition government of Germany. Chancellor Schröder, who announced in October that he will run for reelection in 2006, has staked his future on the success of the *Agenda 2010* reform package. After arriving at a compromise with the opposition Christian Democrats in the upper house (*Bundesrat*), settling a dispute regarding the financing of tax cuts and how best to loosen labor market rigidities, Schröder's reforms will have a chance to reinvigorate the German economy. However, the reforms are calculated to tackle structural issues, with positive results likely only in the medium to longterm. Thus, 2004 will feature the introduction and absorption of social welfare cutbacks with few immediate, demonstrable improvements in the overall economy. (For detailed analysis, see *Euro-Focus,Germany One Year After the Storm,October 31, 2003.*)

POTENTIAL GDP IN SELECTED COUNTRIES
SOURCE: OECD ECONOMIC OUTLOOK, DECEMBER 2003



Although there are indications of rising consumer and business confidence and a brightening picture on the unemployment front, economic forecasters continue to predict modest growth of 1.4 to1.7 percent in 2004 for the idling German economy — possibly less if the euro does not lose some of the value it gained late in the year relative to the dollar. The importance of putting Germany back on track cannot be overestimated. As the Eurozone's largest economy, Germany is integral to the economic well-being of Europe as a whole. Schröder has shown a strong ability to weather the backlash generated by *Agenda 2010* so far, and continued resilience will be required of him throughout the period of implementation. But with polls showing support for the Chancellor's Social Democrats at only 25.5 percent (versus 47.4 percent for the Christian Democrats), a yardstick of the public's mood will come in the form of four state elections in autumn 2004.

France

For France, 2004 is a year full of uncertainties. Alongside Germany, France's poor economic performance has had a detrimental impact on that of the continent. Chirac's ambitious plan of economic reforms will be strongly challenged by the trade unions and his political adversaries. At the roots of France's poor performance lie several causes: the excessively tight monetary policy imposed by the European Central Bank, the Stability and Growth Pact and its strict fiscal policy, the increasing inefficiency of French agriculture, and the country's strict labor laws. Whatever the origin, the 3 percent ceiling for the budget deficit has been breached. Forecasts for 2004 are not much different.

Europe's third-largest economy is still victim of a vicious circle — rigidities in labor and product markets, high social security payments, and insufficient investment. The Bank of France has forecast a 0.2 percent increase in economic growth for France in 2004 compared to 2003, which fails to reach the goal set by the government of a 0.5 percent increase. The government hopes that cuts in income tax and corporate charges will boost economic growth, although it is far from clear that the growth will be sufficient to reduce France's deficit as a percentage of GDP under the Stability and Growth Pact limit for 2005.

The political fate of France's prime minister Jean-Pierre Raffarin is under question, as he faces plummeting popularity, economic crisis, center-left domestic opposition against his labor market and welfare reforms, and internecine conflict within the government. The next regional elections in the spring will be crucial for Raffarin. Yet, the question is no longer whether Chirac will let go of his embattled prime minister — but when, and who will replace him. A possible replacement is Michèle Alliot-Marie, currently the defense minister. In any case, a reshuffling of the government is almost certain for the spring of 2004, when Nicolas Sarkozy, currently the minister of interior and the leading candidate for the next presidential

election in 2007, might become finance minister.

Relations between France and Germany have never been stronger. Beyond their common stance against the war in Iraq, Franco-German unity has become especially prominent in the matter of the constitutional treaty and discussions of alternative paths of integration should the treaty die. Franco-German closeness has been symbolically emphasized by moves such as the appointment of France's Jean-Claude Trichet to the presidency of the European Central Bank, as well as Chancellor Schröder's request for President Chirac to represent him at a European Council meeting in October. As far-fetched as it may be at this time, the notion of a political union of France and Germany has been raised in several quarters. Although each state will take its own approach to post-Iraq relations with the U.S., France and Germany will continue to speak mostly with one voice in, and, increasingly, outside Europe.

United Kingdom

Prime Minister Tony Blair no doubt will focus as much as possible on domestic matters with the hope of regaining some of the appeal he has lost over the past tumultuous year. But that will not be easy. For starters, the sudden downfall of Iain Duncan Smith and the rise of Michael Howard as the new Conservative leader can only strengthen the Tories. Howard has pledged his leadership to increasing cohesion within the party by refreshing the attack against New Labour.

Blair can expect to hear much criticism of the largely unsuccessful efforts to improve public services, particularly in health care and transportation. The tax increase used to finance the improvements in both of these sectors has earned a poor return on investment for the Labour Party and Britons in general. And although the British economy is expected to continue to outpace growth in the Eurozone (2004 forecasted growth of 2.8 percent in Britain versus 1.8 percent in the Eurozone), there are signs that all is not well. Productivity in Britain remains well below the rates in France, Germany, and the United States. In November, the Bank of England raised interest rates from 3.5 percent to 3.75 percent, likely the first step in a gradual progression back up to about 5 percent by the end of 2004. Historically low interest rates over the last few years resulted in a housing boom, which provided a much-needed boost to the economy. But with interest rates on the rise, Britain may face a dual drag on the economy in the form of a decline in housing purchases and an increasing debt burden to a population already dangerously overburdened with debt (the household sector's debt to disposable income ratio was 120 percent at the end of 2002).

In 2004, Blair will likely continue to work with his colleagues in Germany and France to bridge the vast differences separating them over the war. But this will not be an easy task. The likely areas of focus within the EU for the upcoming year (excluding enlargement)—European Security and Defense Identity (ESDI), the constitutional treaty, and economics—are arenas in which serious disagreements remain between Great Britain and the continental members. ESDI may prove to be the most serious as France and Germany, along with smaller states, would like to push forward with the concept. Despite Blair's conciliatory line with regard to ESDI, he remains committed to a strong U.S. role in European security, which only NATO can guarantee. Yet, there are limits to Blair's ability to follow the U.S. lead on all matters pertaining to the war against terrorism, and if not in 2004, these limits will be sorely tested in 2005.

A Troubled Partnership

The Atlantic Alliance is facing slow recovery from what was arguably its most severe crisis ever, the split over the use of force (mainly American force) in Iraq and its aftermath. Late in the year, a general consensus emerged of the need to move beyond past differences and face the demanding realities of reconstruction and transition in Iraq (as confirmed by a broad willingness to forgive much of the Iraqi debt), and to continue a concerted war against global terrorism. Importantly, there exists a broad agreement that success in Iraq is crucial for that war to be won. This agreement includes not only the European members of the U.S.-led coalition of the willing now in Iraq—notably the UK, Spain, Poland, and Italy (*Euro-Focus,The Troubled State of Our Friends, October 17, 2003)*—but also those countries that objected to the war in early 2003, including France and Germany. In 2004, a withdrawal by any nation from Iraq is very unlikely, but the enlargement of the coalition of the willing with the deployment of additional forces from other countries cannot be ruled out if needed.

After much speculation that Germany had shifted its alignment to France as its partner of choice, Chancellor Schröder appears deeply committed to restoring closer bilateral relations with the United States in 2004. Although the deployment of German troops in Iraq can be ruled out,

Germany will assist in such other tasks as creating and training an Iraqi police force. Germany's focus will continue to be in Afghanistan, where Germany remains committed to leading, and even expanding, the International Security Assistance Force (ISAF) mission. Despite a broad willingness to cooperate for the stability of Iraq, France remains the United States' most outspoken critic in Europe. As the year unfolds, France is likely to maintain its emphasis on the need for a quicker timetable for the transfer of power to a meaningful Iraqi government.

By and large, the idea of internationalization finds a receptive audience in Washington. However, splits within the administration have caused mixed signals to be sent. The Pentagon's announcement of barring companies based in non-coalition states, including France, Germany, and Russia, from bidding on multi-billion dollar post-war contracts is the type of approach that can imperil the recently improved transatlantic atmosphere. Even more than France, Germany and Russia reacted with notable anger, but the controversy was somewhat defused by the capture of Saddam Hussein in mid-December. On the whole, Europe's interest in muting discord over Iraq and other transatlantic disputes is echoed in Washington in an election year. Yet goodwill may not be enough to resolve disputes during the coming 12 months.

… a general consensus emerged of the need to move beyond past differences and face the demanding realities of reconstruction and transition in Iraq…

After the disaster of Cancun, the Doha round of trade talks has fallen off track. It will take considerable effort from all parties, not to mention a willingness to compromise that was notably absent this fall, to inject momentum back into the process. The EU has quietly taken the lead in attempting to get all parties back to the table, indicating a newly found flexibility on a number of contested issues—but the political calendar is just too demanding for both Europe (depending on EU Trade Commissioner Pascal Lamy's fate in a new Commission) and the United States (depending on U.S. Trade Representative Robert Zoellick's position in a second Bush administration). At any rate, the United States' rescission of tariffs on imported steel removes a major irritant in trade relations between the United States and the world's steel producing nations, especially the EU.

On the broader security agenda, the tensions over Iraq have obscured a great deal of smooth and effective transatlantic cooperation in the wider war on global terrorism, particularly in Afghanistan and against Al Qaeda, as well as with regard to the shared or complementary use of nonmilitary tools like intelligence and financial means of pressure. More such cooperation can be expected in 2004.

Many in Europe are increasingly concerned about Iran and what is seen as a potential conflict that could prove more serious, diplomatically and militarily, than Iraq. A concerted diplomatic effort by France, Germany, and the UK with regard to Iran's nuclear program must be counted as an encouraging success for European foreign policy, one that has propelled Europe to the lead in engaging Iran. At the turn of the year, this effort seemed reinforced by the U.S. reaction to the terrible earthquake in Iran, which provided an opportunity for new bilateral initiatives between Washington and Tehran.

Iran is only one of many global security issues on the agenda for 2004 and beyond. North Korea is another, to be sure, but so is Pakistan, where late in the year another attempt at Musharraf's life served as a reminder of the extraordinarily fragile conditions that prevail in this country and its region. Finally, and perhaps most of all, there remains the Israeli-Palestinian conflict, an underlying cause of much of the rising extremism in the Middle East. Although all agree that the *status quo* there is not viable, there is little agreement on what can be done to relaunch the peace process in a region that is at the mercy of new acts of terror that would spill over into the region.

The year 2004 will not be the time for U.S.-initiated radical action on any of these issues. With the November election gearing up, the Bush administration will seek to avoid conflict on the international scene. This situation offers Europe a window of opportunity to present ideas of its own, but regretfully the states of Europe are likely to be so very involved with their own problems in moving on with a heavy EU-centered agenda as to make them unable to seize that opportunity either.

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