The Transatlantic Economic Challenge

A Report of the Global Dialogue between the European Union and the United States

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We are in a decisive period for the institutions of the Euro-Atlantic community and the 34 countries that are members of either the European Union or NATO, or both—with more yet to come. Issues of concern—security, economic, political, and societal—have become increasingly bundled into circumstances that cannot be addressed by any nation alone, however powerful, or any single institution, however influential. Under such circumstances, capabilities, too, need to be bundled for use through a comprehensive approach that combines both hard and soft power into smart power, and also relies on both the states and the institutions that can best provide or even share the needed capabilities. Americans and Europeans must work together to develop these comprehensive approaches to today’s challenges and thus ensure that tomorrow’s solutions are effective for them and the rest of the world.

It is with this belief that in early 2008 the Zbigniew Brzezinski Chair in Global Security and Geopolitics at the Center for Strategic and International Studies (CSIS) launched A Global Dialogue between the European Union and the United States. The dialogue is centered on five broad issues that represent serious challenges for the states of the Euro-Atlantic community but lend themselves especially well to ever-closer relations, consultation, and cooperation between the European Union and the United States:

- Issues of stabilization and reconstruction, and the problem of failing states;
- The dilemmas of climate change, including mitigation of its causes and adaptation to its impacts;
- The risks of energy scarcity and strategies for sustainable energy security;
- Challenges in the world economy and the new modalities of global economic governance;
- The need for strategic convergence and the formation of a Euro-Atlantic security strategy.

The report that follows was developed in the context of an especially significant global economic crisis that originated mainly in the United States and Europe. As argued by the former president of Mexico, Ernesto Zedillo, “I am absolutely convinced that we are in the present mess, in no small measure, because of a lack of global governance of essential phenomena inherent in our increasing interdependence.” This report examines the contributions that can and should be made by the United States and the European economies. The effectiveness of these contributions will largely depend on their continued cooperation and the coordination of their own decisionmaking processes, and the report also examines ways in which progress can be made in these areas.
This report is the fourth in a series that began with Enhancing Stabilization and Reconstruction Operations, by Julian Lindley-French (and Robert E. Hunter), and includes Transatlantic Cooperation for Sustainable Energy Security, by Frank Kramer and John Lyman (with Robin Niblett) and A Shared Security Strategy for a Euro-Atlantic Partnership of Equals, by Simon Serfaty and Sven Biscop. Scheduled for release later this year is the fifth and final report, coauthored by Christian Egenhofer and David Pumphrey, on climate change issues.

I am deeply grateful to my friends and colleagues Bruce Stokes and Hugo Paemen for their willingness to commit their talent and experience to the preparation of this paper and for leading the discussions that led to its conclusions. In this context, they both join me in extending our thanks to the many leading experts on both sides of the Atlantic who shared their ideas and made suggestions privately or in the course of meetings specifically arranged for this project in Washington, D.C. This was a large group, which makes it difficult to thank each participant individually, but we wish to acknowledge a special debt of gratitude to Bruegel director Jean Pisani-Ferry and his colleagues, who helped us with the development of this effort and hosted an invaluable discussion in Brussels.

Derek Mix, then my close collaborator at CSIS but now an analyst with the Library of Congress, also made important contributions in assisting the direction of our work on this paper, and we are grateful for that as well.

As with two preceding programs on EU-U.S.-NATO relations completed by the Brzezinski Chair in the period 2004–2007, A Global Dialogue between the European Union and the United States is made possible by a grant from the European Commission. This project was launched in partnership with the CSIS Europe Program, now directed by Heather Conley.

I am tremendously thankful for this continued support.

Simon Serfaty
Zbigniew Brzezinski Chair in Global Security and Geostrategy
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The fate of the transatlantic economy is the transcendental challenge facing the European Union and the United States. Governments on both sides of the Atlantic have a self-interest, as well as a responsibility to the world community, to work together in this time of economic upheaval both in dealing with the crisis and in devising Euro-American economic initiatives to ensure a more sustainable and prosperous future. This effort will require a shared EU-U.S. vision and a set of transatlantic best practices that will support mutual interests and elaborate an economic governance structure that better reflects the diffusion of interests in the modern international system.

The transatlantic market is a $27-trillion economy with 800 million consumers. Europe and the United States account for roughly half of total global trade. And commerce across the Atlantic in goods alone exceeds $600 billion. The United States is the recipient of nearly three-quarters of European foreign direct investment, and Europe is host to more than half of U.S. overseas investment. So Europeans and Americans, let alone people all over the world, have a huge stake in the European Union and the United States creating a more sustainable and prosperous future.

Europeans and Americans need to work together to broaden and deepen the transatlantic market; reform the multilateral trading system; restructure the World Bank and IMF; better coordinate monetary, fiscal, and financial sector policies; improve ties with the developing world; and jointly address the challenges posed by China, India, and other emerging market economies.

To that end, the European Union and the United States should:

- Participate in, contribute to, and lead the inevitable reforms of the international economic system.
- Establish international task forces to lead reform of the World Trade Organization and the IMF based on principles of globality, stakeholdership, democracy, and effectiveness.
- Build on the coordination during the crisis between the U.S. Federal Reserve System and the European Central Bank and use that cooperation as a model for similar interaction among other regulators.
- Develop parallel systems of financial sector rules, regulatory practice, and risk assessment to establish a de facto global standard to ensure investors of greater safety in the future.
- Coordinate EU-U.S. activities in support of G-20 goals.
- Complete the Doha Round.
- Redouble efforts to ensure that regulatory processes enhance transatlantic trade and investment.
- Pursue sector-specific agreements that eliminate transatlantic tariffs.
- Consider a transatlantic free-trade agreement or a manufacturing-only or services-only U.S.-EU accord.
- Work together in dealing with China and other emerging market economies, such as India and Brazil.
- More closely coordinate strategies in negotiating preferential trade agreements and explore a joint trade agreement with India.
- Provide all products from the poorest nations of Africa, Asia, and Latin America with duty-free, quota-free access to EU and U.S. markets.
- Develop a complementary civilian reconstruction capability and exercise this expertise jointly to help reconstruct failed states.
- Use progress toward meeting the Millennium Development Goals to judge foreign aid effectiveness, jointly end the tying and earmarking of aid, and develop common standards for accounting and measurement of the success of foreign aid.
THE TRANSATLANTIC ECONOMIC CHALLENGE

Bruce Stokes and Hugo Paemen

The fate of the economy is the transcendental transatlantic challenge. The Euro-American marketplace, the world’s largest economic space, has contracted at a rate not seen since the Great Depression, dragging the global economy down with it. The European Union and the United States have a self-interest, as well as a responsibility to the world community, to work together in this time of economic upheaval in both dealing with the crisis and in devising Euro-American economic initiatives to ensure a more sustainable and prosperous future. These may include broadening and deepening the transatlantic market; reforming the multilateral trading system; restructuring of the World Bank and IMF; better coordinating monetary, fiscal, and financial sector policies; improving ties with the developing world; and jointly facing the challenges posed by China, India, and other emerging market economies. This effort will require a shared European-American vision and a set of transatlantic best practices that will support mutual interests and elaborate an economic governance structure that better reflects the diffusion of non-Euro-American interests in the modern international system.

The Crisis

The 2008–2009 financial crisis and ensuing economic downturn shook the very foundations of the transatlantic market. They posed challenges for the European and American economies not seen since the Great Depression in the 1930s. But the “Great Recession” also created new opportunities for deeper intra-European and transatlantic integration, both as a means of coping with the current difficulties and to insure a more sustainable economic environment in the future.

The EU economy contracted severely in 2009. The U.S. economy suffered only somewhat less. A slow and shallow recovery is expected. And since the United States and the European Union account for four-fifths of the global economy, this deep transatlantic recession spells trouble for the entire world.

Not surprisingly, joblessness rose. Unemployment is projected to reach 10.9 percent in the European Union and 10 percent in the United States by 2010, both levels of redundancy not seen in nearly three decades (with, it will be recalled, unsettling political consequences in all the main European countries, as well as in the United States).
International commerce, which in recent years has been driving growth in the transatlantic area, slowed. European exports are expected to decline by 12.6 percent in 2009. American exports will fall by 22 percent, based on their performance in the first third of 2009. Transatlantic trade, which has more than doubled in the last decade, is now contracting. In the first four months of 2009, as the recession deepened, U.S.-EU trade in goods and services was down 18 percent compared with the same period in 2008.

The transatlantic capital market, which in recent years had increasingly become a single market with trading centers in New York and London, has been particularly hard hit. The financial crisis had its origins in the rapid rise in housing prices on both sides of the Atlantic. That market has now collapsed in the United States, Spain, Britain, the Netherlands, and Denmark. The unwinding of the real estate market led to the implosion of financial derivatives, many of which were based on mortgages, and severe troubles for banks on both sides of the Atlantic, which had made these mortgages and bought these derivatives. In June 2009, the IMF warned that European banks still held at least $375 billion in bad loans and American banks another $250 billion.

The transatlantic cost of this crisis in terms of forgone economic activity has been profound. In the first quarter of 2009, the Congressional Budget Office estimated that the U.S. output gap, the difference between potential and actual economic growth, was 6.2 percent. And, in 2010, EU economic growth is expected to fall 3.6 percent below its potential.

Never before have Americans and Europeans had such a mutual interest in weathering a common economic storm. Both the European Union and the United States, as major trading partners that account for more than half of world commerce, have a stake in reversing the contraction of transatlantic and global trade. Both have a deep self-interest in promoting growth to generate new sources of demand. Any rise in protectionism—such as a hike in tariffs, new export subsidies, or buy-national provisions in economic stimulus packages—threatens both European and American business interests and jobs.

At the same time, both Europe and the United States have subsidized their banking sectors and their auto industries in an effort to stem the bleeding and jumpstart economic growth. Ensuring that such government intervention does not discriminate against foreign investors or distort competition is a mutual priority to avoid disintegration of the transatlantic market. And common exit strategies are needed for unwinding the state’s expanded role in the economy once this crisis is past.

Many current economic difficulties stem from shortcomings in transatlantic (and European) economic integration. The rules of the road for financial transactions have not kept pace with the tremendous increase in global financial activity, led by surges in transatlantic investment, mergers and acquisitions, and issuance of securities. Without a common European and American approach to assessing risk, rating bonds, and prudential supervision, imprudent activities in one region have reverberated across the transatlantic economy and throughout the world.
In sum, today even more than in the recent past, and in the future no less than today, the economic fate of Europe and America are inextricably intertwined.

**What Is at Stake**

The transatlantic market has its antecedents in the nineteenth century, when European investment built American steel mills and railroads, American cotton was spun in British mills, and American beef was often the main course for Sunday dinners in Berlin and Paris. Today’s transatlantic market reflects an even deeper integration.

In 2008, trade across the Atlantic in goods alone exceeded $600 billion. Europeans bought nearly 4 times as much merchandise from the United States as did the Chinese and 15 times more than that bought by the Indians. Similarly, in 2007, the European Union sold the United States nearly 4 times what it exported to China and more than 9 times what it sold to India.

Together, as Daniel Hamilton and Joseph Quinlan so ably document in their annual survey *The Transatlantic Economy*, Europe and the United States accounted for roughly half of total global trade in 2007. Europe is the world’s largest trading entity, and before the economic crisis, its share of world exports was actually growing. The United States, for its part, is the third-largest exporter of goods in the world. And, when exports of goods and services are combined, the European Union is the largest exporter in the world.

But it is foreign investment that is the real driving force in the transatlantic economic relationship. Three-fifths of all world foreign direct investment is in the transatlantic marketplace and nearly three-quarters of annual mergers and acquisitions. The United States is the recipient of nearly three-quarters of European foreign direct investment and Europe is host to more than half of U.S. overseas investment. In 2007 alone, U.S. investment in Europe was three times larger than total American investment in all of Asia. And EU investment in the United States was 12 times larger than European investment in China in 2006.

An estimated 4 million Europeans now work for American companies in Europe and 3.6 million Americans are employed by European firms in the United States. The combined output of U.S. affiliate companies in Europe and European affiliate firms in the United States is equivalent to the GDP of Mexico or South Korea. The sales of American affiliated firms accounted for 22 percent of the Irish GDP and 17 percent of the British GDP. Affiliates of U.S. multinational corporations accounted for nearly half of all European research and development projects, while British- and German-owned affiliates were the top two foreign R&D investors in the United States in 2006.

And unlike what may be the case in other parts of the world, such growing economic intimacy between the United States and Europe has become increasingly immune to transatlantic political tensions, as was shown during the bitter clash over the war in Iraq, which did not impede transatlantic economic relations whatsoever.

The economic footprint of the transatlantic market is evident in its sheer size, the number and buying power of its consumers. The European Union and the United States have a combined
The transatlantic economy accounted for over half of world GDP, based on market exchange rates. Based on purchasing power parity rates—a better indicator of average living standards—the transatlantic economy still ranked as the largest in the world in 2007, representing more than four-fifths of world GDP. Developing Asia, in contrast, accounted for roughly a quarter of the global economy. And, in 2008, per capita income in the European Union was $33,400 and $47,000 in the United States, making the transatlantic market home to the largest body of well-to-do consumers in the world, who accounted for three-fifths of personal spending around the globe.

It is little wonder then that the United States and the European Union dominate the international market for many individual products. In 2009, Europe and the United States will account for an estimated 45 percent of world auto production. In 2006, 55 percent of total world chemical sales took place in either the European Union or the United States. Looking to the future, the services economies of the United States and Europe represent the sleeping giant of the transatlantic economy, with European countries accounting for 5 of the top 10 export markets for U.S. services providers. And sales of services by European affiliates in the United States more than double U.S. services imports from Europe, a sign of the growing presence of EU services providers in the American market.

Thus, talk of a relative demise of the transatlantic economy—relative to the rest of the world or relative to Asia or China—is premature, even if growth rates in other parts of the world are higher because mature economies tend to grow more slowly. The Euro-American economy is built on an unparalleled political and security foundation. Moreover, opportunities for growth abound thanks to opportunities for further EU enlargement, dynamic demographic trends in the United States, and under-realized prospects for new Euro-American partnerships with countries around the entire tri-continental Atlantic area, from Canada and Brazil to Morocco and South Africa.

**Coordination of Monetary, Fiscal, and Financial Policy**

The financial crisis and the ensuing economic downturn have been stark reminders that the forces driving transatlantic integration are mutually reinforcing both in a business cycle upswing and when the economy heads south. In this shared and, at times, volatile environment, European and American monetary, fiscal, and financial policies need to be mutually reinforcing if they are to cope adequately with the challenges posed by what is increasingly a single transatlantic capital market.

In the face of the recent economic turmoil, the U.S. Federal Reserve System (the “Fed”) and the European Central Bank (ECB) demonstrated an unprecedented willingness and ability to cooperate, building on common views and longstanding interaction over the years. At first out of synch in their assessment of the problem and its severity, they found ways to work in parallel that empowered both institutions and could serve as a model of transatlantic policy coordination going forward.
The Fed dramatically lowered interest rates. It acted as “lender of last resort” to keep credit flowing, creating new loan facilities targeting the troubled parts of financial markets. And it established swap facilities with other nations’ central banks, including the Bank of England and the European Central Bank, to ensure that both the United States and other treasuries had access to sufficient foreign reserves to meet their obligations during the crisis.

The ECB also took exceptional actions, albeit less proactively. Interest rates were lowered, although not as much as in the United States. In July 2009, the ECB began quantitative easing, similar to that done by the Fed, buying bonds. The ECB also provided funding against an expanded list of eligible assets for use as collateral in refinancing operations. This expansion of liquidity is reflected in the growth of the ECB’s balance sheet, which was equivalent to 16 percent of the euro-area GDP by mid-2009. By comparison, the size of the Fed’s balance sheet had reached only 14 percent of U.S. GDP at the end of April 2009.

Transatlantic cooperation on financial sector regulation has been less heartening, highlighting the difficulties posed by balkanized sovereign regulatory jurisdictions. Britain nationalized some banks. The United States effectively took control of some institutions without formally nationalizing them. For a long time Germany denied it had a problem.

In the wake of the financial crisis, the G-20 group of major economies—whose early meeting in November 2008 resulted from a European initiative that was endorsed by the United States—pledged to reshape regulatory systems to identify and take account of prudential risks; to extend regulation and oversight to all systemically important financial institutions, instruments, and markets, including hedge funds; to improve the quality, quantity, and international consistency of capital in the banking system; to achieve a single set of high-quality global accounting standards; and to extend regulatory oversight and registration to credit rating agencies. For this ambitious agenda to be achieved leadership from Europe and the United States, the world’s premier providers of financial services, will continue to be required.

In pursuit of these reforms, drawing on suggestions by the former head of the IMF, Jacques de Larosière, the European Union has agreed to create a European Systematic Risk Council, led by the European Central Bank, to monitor the stability of the financial system as a whole and to provide an early warning system about threats to that stability. Notably, it will not oversee cross-border institutions. And, should a major financial institution fail, there will be no European-wide authority to establish which countries will have to foot the bill and by what means.

The European Union will also create a European System of Financial Supervisors consisting of a network of national financial supervisors to ensure consistency of national supervision of banking, securities, and insurance. In the case of disagreement between the home and host state supervisors, the new EU-level authority will settle the issue with a binding decision.

The United States has similarly debated vesting the Fed with the responsibility for systemic risk oversight. The Obama administration has also proposed a limited consolidation of financial sector regulation. These proposals have met with an opposition fueled by claims that the Fed failed to
use its existing systemic oversight powers, worries about giving too much power to the Fed, and resistance from existing regulatory bodies and those they regulate.

The objections to systemic risk oversight and regulatory reform on both sides of the Atlantic, let alone across the Atlantic, are a sobering reminder that a single set of rules and practices for the transatlantic capital market are not obtainable any time soon. Even transatlantic coordination of such efforts will be a challenge. Moreover, European moves to impose new rules on credit rating agencies have not been paralleled in the United States. This discrepancy highlights the potential for regulatory friction caused by forcing European and American firms to meet two sets of rules, not unlike that encountered when the United States unilaterally revised its accounting practices.

On the fiscal policy front, the disparate European and American responses to the crisis underscore the inherent shortcoming of a Europe not able to act in unison. Since 1957, a united Europe has spoken with one voice on trade policy. Since 1999, a majority of EU members have had a common currency and monetary policy. But with the European economy contracting at a more rapid rate than at any time since the Great Depression and with government spending needed to reverse the slowdown, Europe’s lack of a common fiscal policy—its inability to tax and spend as one—is glaringly obvious and counterproductive.

The United States committed to spend 2 percent of its GDP to boost discretionary spending to stimulate its economy in 2009 and expects to add 1.8 percent in 2010. Germany will spend 1.5 percent of GDP in 2009 and 2 percent in 2010. But many other European nations plan far less new spending, and Europe as a whole will fall short of the IMF’s goal of 2 percent additional discretionary spending. European governments argue that they bolster their economies through automatic stabilizers: jobless benefits, retraining programs, and direct payments to firms to keep workers in their jobs. Such spending does reduce the transatlantic discrepancy in burden sharing, but only marginally.

The European and American disparity in fiscal power and practice has also been apparent in the subsidies that governments on both sides of the Atlantic poured into the banking sector and the auto industry once the crisis began. The United States agreed to bailout General Motors on the condition it divest itself of Europe-based Opel. Germany subsequently decided to bailout Opel at the expense of jobs in Belgium. These were one-country solutions in a multi-country market that distorted competition and threatened to discourage future foreign investment.

The expected prolonged period of recovery from the crisis will also test American and European management of the euro-dollar exchange rate. The euro strengthened against the dollar some 8 percent in the first half of 2009, raising European concerns that the United States would pursue a weak dollar policy to spur its economic recovery and to lower its dollar-denominated debt burden. The fact that the U.S. current account surplus with the euro area increased 50 fold, albeit from a very small base, from the first quarter of 2008 to the first quarter of 2009, tended to reinforce that suspicion. Any perception of a beggar-thy-neighbor policy by one party or the other will make cooperation much more difficult on a range of other issues. If the long-run goal of both the European Union and the United States is to create a broader and deeper transatlantic market
and to reinforce the global predominance of the transatlantic capital market, some modicum of euro-dollar exchange rate stability will be essential.

The objections to ambitious financial reform on both sides of the Atlantic and the U.S.-EU differences over stimulating the economy and subsidies highlight the challenges facing a transatlantic approach to these issues. Nevertheless, there are lessons that Europe and America can learn from recent experience that can spur closer monetary, regulatory, and fiscal policy cooperation in the future.

Drawing on that experience, we offer the following recommendations:

- The Fed and the ECB are the winners in this crisis; they emerge more powerful and respected. Their formal and informal coordination before and during the crisis can be built upon and serve as a model for similar cooperation between other regulators.

- The success of the broader G-20 response to the crisis depends upon the success Europe and the United States have in assessing systemic risk and in coordinating regulatory oversight. In so doing, they can set the de facto global standard, both ensuring greater safety for world investors and entrenching an important competitive advantage for European and American financial service firms.

- A common set of transatlantic financial rules and regulators is not currently foreseeable. But close cooperation in parallel reform efforts can avoid inconsistent regulation for what is already effectively a single transatlantic capital market.

- The discipline inherent in a common fiscal policy is beyond reach. But European and American governments intent on subsidizing industries could usefully agree to limit the types of subsidy that are allowable, state the objectives of each bailout, agree on timelines for their duration, refrain from imposing conditions on the recipients of state aid that require them to discriminate against foreigners, and publicize all other restrictive measures associated with subsidies.

**Broadening and Deepening the Transatlantic Market**

For some time, Brussels and Washington have engaged in a bilateral effort to dismantle obstacles to trade and investment and to encourage regulatory convergence. The resilience of this dialogue through disputes over bananas and chickens, rising anti-Americanism in Europe and foreign policy disagreements over Iraq is testimony to the vital economic importance of the transatlantic market to both Europe and the United States and their mutual commitment to strengthening economic ties despite the distractions.

This commitment reflects the fact that the transatlantic market provides the economic foundation for European and American diplomatic and security initiatives that contribute to global stability. EU-U.S. deliberations promote long-standing mutual values—transparency, accountability, a
limited role for the state in the economy—that have spurred economic growth while promoting
democratic institutions and practices.

In 1995, in Madrid, American and European leaders agreed on a New Transatlantic Agenda,
which envisioned creation of a New Transatlantic Marketplace. Since then, there have been
repeated but inconclusive efforts to realize this ambition. Initial attempts at mutual recognition of
technical standards and testing produced scant results. In 1998, the European Commission
suggested an ambitious negotiating package involving mutual recognition of standards and
certification, a reduction of industrial tariffs to zero by 2010, a bilateral free trade area in services,
and the establishment of a new dispute settlement procedure. The initiative was never fully
embraced by the United States, however, and it failed to win support from key EU members, most
notably France.

In 2007, U.S. president George W. Bush and German chancellor Angela Merkel agreed to create a
Transatlantic Economic Council (TEC) as a permanent, high-level group tasked with
“rationalizing, reforming, and, where appropriate, reducing regulations,” “achieving more
effective, systemic and transparent regulatory cooperation,” and “removing unnecessary
differences between our regulations to foster economic integration.” While the TEC has advanced
some transatlantic regulatory cooperation, it has not produced the deeper economic integration
that is its core purpose. The reasons for failure are many. Most important, the effort has lacked a
broad strategic vision. The transatlantic dialogue has far too often allowed itself to be stymied by
disagreements on technical trade issues, most recently over safety standards for poultry.

The cost of being mired in the weeds is increasingly apparent. While transatlantic trade has more
than doubled since 1995, many of the benefits of deeper transatlantic economic integration have
yet to be fully realized. Tariffs, the traditional obstacles to commerce have all but been eliminated
across the Atlantic, but many nontariff trade barriers remain. The elimination of all such obstacles
to transatlantic business would lift Americans’ per capita income by up to 2.5 percent and
Europeans’ income by up to 3 percent, according to a 2005 study by the Organization for
Economic Co-operation and Development (OECD). And, the U.S. Chamber of Commerce and
Business Europe estimate that achievement of even the more limited TEC agenda would add more
than $10 billion to the transatlantic economy thanks to reductions in cost, avoidance of regulatory
burdens, and new opportunities to grow markets.

Deepening and broadening the transatlantic market can be pursued in a variety of ways: through
the TEC process, through more targeted sectoral economic integration, or through an effort to
eventually create a single market across the Atlantic. These activities can be complimentary, rather
than contradictory, and could be pursued in parallel fashion with sequential objectives and
timelines. Or, one or more of these objectives could be pursued independent of each other for
their own sake.

If the TEC did not exist, something like it would have to be created to structure the transatlantic
economic dialogue. So whatever the U.S.-EU goal for the economic relationship, a strengthened
and ambitious TEC or its successor is the vehicle for pursuing that goal.
For the duration of the global economic crisis, the TEC should focus on the recovery and revitalization of the transatlantic market and the global economy. The TEC should take the lead in coordinating the cross-border regulatory cooperation called for by the G-20 at its summits in November 2008 and April 2009 and thus remove suspicions about the G-20’s political will to go beyond mere declarations. It can also continue to drive the vitally important cooperation efforts of individual nonfinancial regulatory agencies. As such, it can serve as a broad, informal systemic risk mitigation mechanism. In addition, by deepening and broadening regulatory cooperation and dialogue across the Atlantic, the TEC can reduce the risk of destabilizing U.S.-EU trade and investment disputes, thus reducing market uncertainty during the crisis and in its aftermath. And a better-functioning and higher-profile TEC can reassure financial markets that the transatlantic political and economic partnership will not fragment under pressure and will emerge from the current downturn even stronger.

In the medium term, in pursuit of its mandate to minimize regulatory barriers to commerce, the TEC should develop comparable EU-U.S. regulatory decisionmaking processes, with, at minimum, agreement on underlying principles and regulatory objectives, mutually compatible transparency, including an early-warning system for new regulations under development, similar timeframes, appeal procedures, and post-regulatory monitoring. The objective should be to ensure that transatlantic regulatory decisionmaking enhances rather than deters transatlantic trade and investment.

The development of comparable standards can create important competitive advantages for European and American firms, while extending the influence of shared transatlantic values. A $27-trillion U.S.-EU market with 800 million consumers and a common standard for a new cell phone or a clean automobile engine will create scale economies that will benefit consumers in both the transatlantic and global markets. Moreover, it would give European and American firms an advantage when competing with Chinese firms whose government is already using Chinese standards to give its firms a competitive edge. Common U.S.-EU health and safety standards for imports such as toys, fruits, and vegetables can raise the quality of goods European and American consumers buy. This would also make it easier for third countries to sell into a transatlantic market with one, not multiple, standards.

In the long run, the TEC should become a venue for discussion of issues that are an inevitable consequence of economic integration, but are politically explosive and have not been on the agenda to date, such as tax harmonization, common rules on investment, and freer movement of people.

Limiting transatlantic economic integration to regulatory convergence constrains ambition, however. The post–Uruguay Round agreements liberalizing trade in telecommunications, financial services, and information technology demonstrate the viability of sector-specific initiatives to remove barriers to commerce. Groups of like-minded countries can eliminate all tariffs or other trade impediments in a nondiscriminatory fashion and open such agreements to participation by other nations.
The European Union and the United States could initiate such sector-specific agreements—for green technologies or paper products or chemicals, to name just a few items—as a means of both stimulating transatlantic commerce in these goods and encouraging others to join the accord. Such sector-specific arrangements may prove particularly useful if the Doha Round of multilateral trade negotiations continues to stagnate.

Washington and Brussels might also consider a mutual elimination of all tariffs on manufactured products, as suggested by the Confederation of Danish and Swedish Industries. Or, creation of a transatlantic free trade area in services, building on the proposal initially suggested by the European Commission a decade ago. The U.S. Coalition of Services Industries now supports such an effort.

Now that the European Union is negotiating a free trade agreement with Canada and already has one with Mexico, and the United States has a free trade deal with Canada and Mexico, the absence of a transatlantic free trade area (TAFTA) becomes all the more glaring after more than two decades of informal discussions. The U.S. National Association of Manufacturers and Business Europe are studying the advantages and disadvantages of such an accord. And it is widely supported by a range of former trade officials.

A transatlantic free trade initiative has repeatedly been rejected out of fear that it would impair first the Uruguay Round and then the Doha Round. If the Doha Round is soon completed or if it cannot be revived, there is little prospect of another round any time soon, so such concerns about undermining the multilateral process will be moot.

Agriculture is a far more difficult issue, since all free trade agreements are, by World Trade Organization (WTO) rules, to deal with “substantially all trade.” Since that requirement is now honored in the breach by many free trade agreements all around the world, a TAFTA that excluded agriculture would set no adverse precedent. Nor there is any reason why American and European businesses and consumers should deny themselves the benefit of greater commerce simply because agriculture remains an intractable issue.

Regulatory convergence, sectoral integration, and creation of a single transatlantic market can be complementary goals with different benchmarks and timeframes. The elimination of nontariff, behind-the-border obstacles to commerce through regulatory convergence is a first-order priority given the de minimis nature of duties in the transatlantic market. At the same time, Brussels and Washington can identify particular sectors of the economy where even deeper integration may be possible. All such efforts can build toward creation of a true single market encompassing both Europe and the United States.

Whatever the transatlantic market integration goals, two elements will be decisive: the engagement of political leadership and the establishment of benchmarks and target dates. The history of formal efforts to deepen and broaden the transatlantic market, as well as experience with European integration, suggests that without high-level political engagement there is no hope of success. The U.S. president, European national leaders, and the leadership of the European
Union must be publically committed to transatlantic economic integration and periodically engaged in pushing the process forward.

Because transatlantic economic integration affects so many citizens in so many new and diverse ways on issues that have traditionally been purely domestic in nature, it is essential that directly elected representatives of those citizens—members of the U.S. Congress, American state legislatures, the European Parliament and national European parliaments—be brought into the integration effort in a meaningful manner. And without visible benchmarks and target dates, bureaucratic inertia will sabotage the most well-intentioned effort.

Given the centrality of the transatlantic economy to the global economy’s well-being and the long history of efforts to deepen transatlantic economic integration, we offer the following recommendations:

- Use the TEC to coordinate EU-U.S. support of the G-20 goals.
- Redouble efforts to ensure that regulatory processes enhance transatlantic trade and investment.
- Pursue sector-specific agreements that eliminate transatlantic tariffs.
- Consider a transatlantic free trade agreement or a manufacturing-only or services-only U.S.-EU accord.

**Partners in Global Economic Governance**

The “historic” nature and dimension of the present economic recession have regularly been highlighted by official and private observers. Their implicit or explicit messages generally try to convey the need for fundamental remedies or reform measures after recovery from the present recession, in order to avoid comparable breakdowns in the future. As said by former Mexican president Ernesto Zedillo, “I am absolutely convinced that we are in the present mess, in no small measure, because of a lack of global governance of essential phenomena inherent to our increasing interdependence.”

It is generally recognized that the economic crisis originated from the financial turmoil linked to the U.S. housing market and the ensuing lack of trust in the existing banking, credit, and insurance systems in the United States and, by extension, in the other Western market economies. The widening and deepening of the crisis into a worldwide economic recession also resulted from the existence of important macro-imbalances in the fairly integrated, but poorly regulated, global financial market. Shriveling trade flows enlarged even more the deflationary impact of the crisis. As a result, the gravity of the downturn revealed the need for a thorough overhaul of most national and international aspects of the existing economic governance. As noted by U.S. president Barack Obama, “No country has a bigger stake than we do in strengthening international institutions—which is why we pushed for their creation in the first place, and why we need to take the lead in improving them.”
Such a reform cannot but take into account the irreversible reality of the globalizing economy, as well as the existing forms of regional economic integration. It must respond to the need for a sustainable, global financial system based on trust at the different levels of economic activity. It must also reflect the reality of wider areas where increased international cooperation has become unavoidable, like the issues of trade in services, investment, free movement of persons, worldwide food supply, global warming, energy, security, and more. And no reform of international economic institutions and regulations will be possible or effective without the collaboration of the large majority of countries in the world that have become active participants in world economic activities and exchanges. Yet, at the core of this effort for reform are the two economic entities that have initiated and strongly supported the existing economic system: the United States and the European Union. How they can work, together or separately, with others on the indispensable overhaul of the international financial institutions will prove decisive.

The same can be said about other areas of international economic governance, like trade, investment, and competition, where the rest of the world can rightly claim transatlantic responsibility and expect active leadership.

Many economic sectors have been affected by the international crisis and would benefit from more efficient international cooperation. Their present degree of international integration and exposure are fairly diverse, and no single set of new arrangements should, or could effectively, cover all of them. Rather, a number of comparable and coordinated efforts are needed. Some of them have already been launched. But it is important that they be conducted as components of a comprehensive concept of multilateral cooperation and be guided by specific and realistic goals, building upon the foundations of existing international arrangements. The primary goal is to close the yawning gap between the increasingly global dimension of most sectors of human activity and the inadequate nature of international governance. This is most conspicuous in the economic and financial areas. There the problem affects nearly all multilateral organizations set up since World War II, including the IMF and WTO, as well as the UN Food and Agriculture Organization, (which has planned a world summit on the food crisis in Rome in November 2009) and the UN Environment Program, with the post-Kyoto negotiations scheduled to open in Copenhagen in December, 2009.

In the last decade, the IMF and the World Bank were said to become increasingly irrelevant. The volume of private capital flows in the world dwarfed the resources of these two institutions, making them seemingly obsolete. It is little wonder, therefore, that the IMF initially reacted slowly to the recent economic crisis even though, by statute and composition, it had the authority, the legitimacy, and the expertise to take up the leadership role. Instead, even before the crisis erupted, the G-20 had begun to function as an operational arm of the IMF, with some informal help by the Financial Stability Board (FSB), whose membership of 24 governments include the United States and six EU members (and the European Commission). In April 2009, the G-20 summit meeting agreed on a globally coordinated reform process with the participation of all stakeholders.
The same summit also released a “Declaration on Strengthening the Financial System” and an action plan that promised “strengthening transparency and accountability, enhancing sound regulation, promoting integrity in financial markets and reinforcing international cooperation.” Ultimate responsibility for reform was still left with the IMF, but with the agreement to expand the membership and broaden the mandate of the FSB. As to the IMF and the other international financial institutions, the G-20 leaders stated their intention to “reform their mandates, scope and governance to reflect changes in the world economy and the new challenges of globalization and (the view) that emerging and developing economies, including the poorest, must have greater voice and representation.”

As the successor to the General Agreement on Tariffs and Trade (GATT), the WTO is the only global organization that has been substantially changed since the immediate postwar years. At the end of the Uruguay Round negotiations in 1994, the WTO widened the scope of its predecessor and fully integrated the agricultural sector, the services sector, and the trade-related aspects of intellectual property into a rules-based multilateral trading system, which the GATT had never been. So reformed, the WTO introduced an element of stability, mainly thanks to a generally respected Dispute Settlement System, and has adjusted its rules and procedures to the present international trade reality. Significantly, the WTO has been less successful where it has reformed the least or where new rules have not been implemented. This was the case with the multilateral trade negotiations, as shown by the slumbering state of the current Doha Round.

Before the start of the Doha Round, proposals were made to include the new dimensions of international trade, such as international investment, international competition, environmental goods, and social rights. But during the negotiations it was decided to focus primarily on trade liberalization in the traditional agricultural and industrial sectors.

Global challenges eventually will require global responses, and efficient reforms will have to reflect and accommodate the various forms of interdependence between the states and their policies. International arrangements are not only needed in the traditional sectors of trading goods, bilateral investment, or transportation treaties, but also in services.

About half a century of experience with the workings, or the absence, of multilateral bodies or arrangements in different sectors can give some guidance as to the general conditions for efficient global economic cooperation. But during most of that period, the Cold War did not let global multilateralism run its normal course. Since then, it has appeared with increasing clarity that smaller and bigger nations need a functioning global system, as economic leadership and adversity have become more diffuse and are accepted with less equanimity.

Taking into account the substantive, historic, and institutional differences between the economic areas of activity, the present global situation prompts us to consider how a more multipolar world will be able—or driven—to harness the irreversible tide toward further amalgamation of the world economies.
In trying to do so, we have to keep in mind the values and basic principles on which we want our society to be based (including a market economy and a system of safety nets for citizens in need), as well as the parallel, but probably asymmetric, developments that will take place in different areas (including finance, trade, investment, geostrategy, security, culture, religion, and others). It seems that the following common components will have to be part of a coherent global system of multilateral governance:

- **Globality and stakeholdership:** States can no longer confront global challenges alone. In other words, global challenges call for global responses as part of a process that must be kept as inclusive as possible. Notwithstanding the essential U.S.-EU leadership role, this implies the notion of a broadly based community of law and the collective responsibility of all the members toward the full accomplishment of that goal. The efficiency and durability of the endeavor will depend on the respect of that commitment.

- **Democracy:** International agreements are concluded between sovereign states. The basic decisions will therefore be most effective if they are taken by consensus, although, lacking consensus, other two- and three-tier arrangements may be sought on specific issues of particular interest to a group of countries. Democracy and stakeholdership will be strengthened by the close association of the citizens of the countries involved in the implementation of and accountability for policies.

- **Efficiency:** The nature of the decisions that have to be taken will require that special attention be paid to their efficiency, on which will depend the relevance of the governance measures within the states and in the global world. Special institutional arrangements will be needed to achieve this goal depending on the complexity and the urgency of the issues. This might imply the creation of a dispute settlement system with appropriate enforcement rules.

During the second half of the twentieth century, the transatlantic countries have developed into the most integrated international economic area. But the relative share of the transatlantic economy in the world economy will gradually diminish. It is, therefore, in the interest of both the United States and Europe to participate in, contribute to, and lead the inevitable reforms of the international economic system, as they have already begun to do in ongoing discussions on the reform of the financial system.

The United States and the European Union need to launch a comprehensive and coherent process to craft a more effective, democratic, multilateral process of global economic governance covering all sectors of economic activity. This initiative will add a new external dimension to existing bilateral cooperation, like the Transatlantic Economic Council. To this end, two transatlantic task forces, consisting of representatives of governments and the private sectors, should review what already works well, how knowledge and analysis can be improved and shared, and where common initiatives can be suggested. This work will be done by individuals from governments and civil society on the basis of their personal knowledge and experience. As their insights proceed, and the subjects require, citizens from other countries can be invited to join in their efforts.
WTO Reform Task Force

The WTO is a rather unique example of a multilateral postwar organization that was fundamentally reformed in 1994. Three developments since that time now justify further reform and even overhaul. First, although international trade was not the origin of the present economic and financial storm, it has been seriously affected by the resulting crisis. Trade will, therefore, probably not offer the salutary remedy to the downturn, but it could be part of recovery, if only by avoiding the harmful effects of growing protectionist tendencies. Second, the 15 years since the creation of the WTO have recast the trading world: developing countries increased their share of the export market from about 15 percent to about 35 percent, China increased its part from about 3 percent to about 9 percent, and global exports of services went from about $900 billion to about $3.5 trillion. Furthermore, worldwide the inward flow of foreign direct investment increased from about $200 billion in 1990 to about $1.5 trillion in 2006. And third, the Doha Round has been a painful trial that seems to have paralyzed rather than invigorated the new institution, with the exception of the Dispute Settlement System. That alone looks like the most obvious illustration of the failed transition from the GATT to the WTO.

Areas for Reform

The present misfortune of the Doha Round has already sparked numerous proposals for change or reform of the trading system, including proposals by a consultative board to the previous director-general of the WTO, Supachai Panitchpakdi; the 2005 Sutherland report, The Future of the WTO; and the 2007 Warwick Commission’s The Multilateral Trade Regime: Which Way Forward? With the majority of these proposals focused on the institutional aspects of reform, perhaps due to the professional backgrounds of their authors, additional benefits and more credibility would come from a serious effort in the substantial areas that are the original mission of the GATT/WTO, namely, the elimination of trade barriers and regulatory reform through a serious revival of multilateral negotiations.

Even before turning to the substantive and institutional issues that might determine these reforms, some prerequisites should be identified.

First, we need a conceptual understanding of the impact of reform on substantial policy areas, such as investment, food or energy supply, product safety, social issues, environment, privacy, and competition policy. These issues must not necessarily become part of negotiations on liberalization because that would overburden the negotiating process. But a better understanding of their interaction with trade liberalization is essential.

Second, a realistic and reasonable resolution of the Doha Round negotiations will be desirable. For such an outcome to be possible, the negotiators and their political masters will have to concentrate on the present agenda (agriculture, nonagricultural market access, services, rules, export financing) by passing the so-called modalities phase as soon as possible. Introducing more subjects or changing the methodology at this late date, as some have suggested, will probably have a further disrupting effect.
Third, thoughts of another vast, comprehensive reform initiative should be abandoned. The best procedure is to start from what is already in place and is working well and from the numerous ideas for reform that have already been discussed. These mainly relate to the updating of the basic principles, the organization, and the institutional aspects of the WTO, its procedures, and negotiating methods.

Three substantive issues require particular attention:

- Special and Differential Treatment for poorer countries was introduced as a general objective in the GATT agreement in 1964 in order to facilitate the participation of developing countries in the trading system. No clear definition of the nations to which this objective applies has been formulated. The increasing diversity in economic development among countries now justifies clarification on the different aspects of this basic principle. This would make it possible to develop a more efficient and integrated approach to existing programs favoring less-developed economies, such as trade facilitation technical assistance, resource support, aid for trade and adjustment assistance. It would be useful to limit eligibility for such benefits to the poorest countries.

- Regional Integration and Free Trade Areas (FTAs) are, under certain conditions, accepted as possible bases for exceptions to the most-favored nation (MFN) principle in the WTO. Their proliferation and variety of makeup and substance make free trade deals also one of the most intangible issues. Some see the unregulated development of such accords as a danger for the multilateral trading system. Plurilateral agreements—meaning an agreement between two or more countries—can be considered as an issue-based variety of the FTAs. Others see them as a useful formula for liberalization, especially in so-called WTO-plus sectors.

- Article XX exceptions (“general exceptions” for reasons of health, safety, morality, and others) and Article XXI exceptions (“security exceptions”) to the MFN rule cover areas that have become more important and sensitive than initially considered.

**Negotiations**

GATT and the WTO were primarily created for the negotiation of the removal of trade barriers and regulatory reform in international trade. Their member states represent a large majority of the nations of the world. The organization of comprehensive multilateral trade negotiations has therefore become an engaging, but also daunting, task. It is generally accepted that, in that respect, the transition from the GATT to the WTO has not been successfully concluded. After the Doha Round it may be advisable to quietly examine the advantages and drawbacks of the negotiating procedures followed in the past, possibly for future negotiations. These include:

- The concept of comprehensive multilateral negotiations, based on the rule of a single undertaking versus more decentralized formulae, such as individual working programs: A more decentralized way of organizing the negotiations is a condition for success in the future.
• The programmatic ministerial declarations to open negotiations: It is very likely that biannual ministerial reviews of the progress achieved and political orientations for future work will make negotiations easier.

• The guiding and management roles of the director-general of the WTO and the chairmen of the Trade Negotiations Committee and sectoral groups: There is room for more effective leadership and guidance by the director-general and the secretariat, but that role should be clearly defined.

• The possible initiating and guiding role of the secretariat before and during the negotiations: A better-equipped secretariat could provide for better preparatory work and realistic analysis during the negotiations. To that end, there should be a high-level, independent research unit within the WTO secretariat.

• The role of ministerial (and summit) versus officials meetings during the negotiations: Ministerial meetings can play a decisive, stimulating role as well as a politically exacerbating and impeding one. They are precious instruments to be used with care.

• The coordination with nontrade agencies of the participating governments: Cross-sectoral coordination is a challenge in any bureaucracy and between international organizations, but it can be useful.

• The possible input from nongovernmental organizations or experts: This is particularly important before real negotiations start. During the negotiations a degree of transparency is substantively important and politically necessary.

• The organization of negotiation meetings outside Geneva: Real negotiations should take place at the headquarters. Political (ministerial) meetings outside can be useful.

• The possible conclusion of plurilateral agreements: Exploration of this formula with all interested parties participating in a “coalition of the willing” is likely to be a useful way to achieve liberalization on specific issues, which would not be possible otherwise.

• The possibility of sectoral agreements: Such agreements have proven to be successful in the past, such as the Information Technology Agreement, and should be repeated.

Institutional Issues

The GATT/WTO has been recognized as a lean and generally effective organization. This should not be changed. But its range of action has been substantially enlarged, which will require institutional adaptation. The following issues merit consideration:

• The Green Room meetings have been for the trade negotiations the informal equivalent of the Executive Board/International Monetary and Financial Committee. Their composition represents the major trading nations and regions but offers also some degree of flexibility depending on the issues on the agenda. Some would like their existence and composition to be formalized. The projected meeting of the trade ministers of the G-20
can be a prologue to such development. As the Green Room formula has generally been considered effective, reform should not be a priority issue.

- The roles of the director-general and the secretariat have never been clearly defined. In light of the increased activities of the organization, some clarification would be helpful. The need for expanded analytical surveillance and early warning capacities will require a substantial adaptation of the Secretarial role and resources.

- Given the increasing overlap of the agendas of the international economic organizations, it would be desirable to have a standing committee for coordination.

- Decisionmaking in the WTO is based on consensus. Some flexibility has been advocated since its scope and membership have enlarged. Formulas, such as critical mass/weighted-majority decisions, can be explored, but will be difficult to introduce and risk becoming distractions from the main goals of the institution. A more effective route, especially for rule-making issues, may be to have the leadership concentrate on the improvement of the (preparatory) consensus-building process, in which broad-based outside advice should be integrated.

**Dispute Settlement**

The cliché, “if it ain’t broke, don’t fix it,” holds, but there is some room for improvement. Greater transparency and easier access, especially for developing countries, should be introduced into the system. The creation of a dispute settlement ombudsman might be considered; clarifications on the criteria for amicus curiae and remand by the Appellate Body would be welcome.

**IMF Reform Task Force**

IMF reform has been on the agendas of the ministers of finance and the central bankers of the world for some years, but the idea has regained traction with the increasing economic and financial crisis. Changes in the international landscape had already forced the IMF to adjust regularly its goals and the ways to achieve them. Established to avoid pernicious competitive exchange-rate changes after World War II, its main goal practically disappeared after the Bretton Woods system collapsed in 1971 following the decision to let the U.S. dollar float. From then on it had to adopt more of a firefighter role in successive financial crises (oil in the 1970s, debt in the 1980s, and Asia, Mexico, and Eastern Europe in the 1990s).

But the IMF’s rigid structure, based on shareholderships (“quotas” fixing the member states’ obligations, borrowing capacity, and voting shares in the fund) did not facilitate these adjustments to changing world conditions, including the increasing economic weight of the emerging economies and the overwhelming growth of private capital flows compared to the IMF’s own resources. Moreover, the conditionality provisions linked to its traditional assistance programs created much dismay and even social upheaval in some of the beneficiary countries.

Defenders of the institution argued that the IMF’s legitimacy and relevance was undermined by the political unwillingness of its larger members to adjust to the new situation created by the
globalization of the world economy. And the reality is that, in the first phase of the present crisis, expectations were not high about the authority the fund could assert in saving the world from a deep recession. But, at the same time, governments and financial institutions were obliged to recognize that no alternative was available to monitor the long-term systemic stability of the financial system. It helped, therefore, that in November 2007, a new managing director got the immediate confidence of the G-20 finance ministers and the Finance Stability Board. The decisions taken by the first two G-20 meetings and the recent actions by the IMF seem to reflect a happy new departure in that respect.

Areas for Reform

A great number of organizations, governments, groupings, and individuals and, since 2004, the IMF itself, have been studying which reform measures will allow the fund to play the role the world can expect from the sole global organization in its area. IMF managing director Dominique Strauss-Kahn set up a Committee on IMF Governance Reform led by South African finance minister Trevor Manuel, who submitted a report in March 2009. Scholars such as Peter B. Kenen, Edwin M. Truman, and Ngaire Woods, among others, have written extensively on the subject. Many recommendations have already been formulated and more will be submitted to the governments of the member states in the near future. Again, some basic options, beyond the present anti-crisis measures, will decide whether reform will really take place and whether the IMF will be ready and capable to fill the undeniable gap that has grown in terms of multilateral financial governance. Some areas will be hard to ignore if such reform is to succeed:

- It is important that the role of the IMF as a watchdog for global economic stability be clearly confirmed and defined, especially in relation to the G-20, G-7, and the Financial Stability Board.
- The IMF must be given the resources and competence to fulfill its role in efforts to overcome the present crisis.
- Beyond the currency crisis, governments should recognize the irreversible nature of the globalization of international financial relations and consider the IMF as the main institution to harness this development.
- The authority of the IMF to exercise the necessary monitoring, surveillance, and enforcement roles, as well as to develop an independent analytical capacity should be reinforced by internal reforms that strengthen its legitimacy as a fully entrusted multilateral organization.

Without trying to establish a complete set of desirable reform measures, which are extensively discussed in the aforementioned proposals, any credible reform initiative would include:

- A more balanced representation of the present membership, especially with regard to emerging developing countries, at the level of the quotas, voting rights, and membership of the Executive Board.
The designation of IMF leadership based on competence and without any national bias.

A thorough review of the functional competences and decisionmaking within the institution.

The integration in the new and remodeled action program of the fund of all resources, instruments, and facilities that have been introduced since the April 2009 meeting of the G-20.

Together with the reform of voting rights, the possibility of using different voting procedures according to the issues at stake should be examined.

On all these issues, transatlantic coordination is needed because of the common responsibility of the United States and Europe as “founding fathers” of the organization and the generally recognized problem of under-representation of the emerging economies, whose presence and active participation is highly desirable. History explains their own present over-representation in the management structure, the U.S. veto, and Europe’s inflated quota and voting rights. But these legacies endanger the effectiveness and legitimacy of “their” organization. It is in their interest, therefore, to sit together and come up with a reasonable solution. Such a solution should be based on the rough equality between the two major economic entities as far as their share of world GDP and world trade is concerned, with recognition of the reality of other elements: the existence of three world currencies (the dollar, euro, and pound), the larger European population, and the role of the dollar as a reserve currency. A voting system with double-variable majority requirements has already been suggested in the general discussions on IMF reform and should be explored further.

The need for improved effectiveness and additional legitimacy is not limited to these two institutions; it also extends to the role and functioning of the World Bank among others. But, compared to the IMF, the need for reform at the World Bank is less acute. Much was accomplished by the major reorganization that took place under then–bank president James Wolfensohn in 1997. This led to important changes in the working procedures of the bank, although they fell short of a fundamental readjustment, as some have claimed. In 2008, bank president Robert Zoellick appointed an external high-level commission led by former Mexican president Ernesto Zedillo to provide additional advice on further governance reform. His report is expected in the near future.

Reforms at the World Bank might include:

- Reversal of the decline in financing for the International Development Agency, the bank’s low-income loan window, and for the bank itself.
- Strengthening of the bank’s coordination role in aid delivery, financial support, and the delivery of basic public goods.
- Adjustment of the bank’s representation and voting procedures along the lines suggested for the IMF to accommodate the growing economic power of emerging markets.
- Strengthening of the bank’s analytical and monitoring capacity, with adequate resources for the secretariat.

Further and similar recommendations for transatlantic coordination and common analysis can undoubtedly be made for other issues on the agendas of multilateral organizations, be it at the level of the United Nations or that of regional institutions. Of overarching importance is whether, after a period of neglect and weakening of the multilateral approach to global issues, the United States and Europe feel a common responsibility for and interest in strengthening or reforming the existing frameworks, so that an open and realistic dialogue among all the nations concerned can take place, based on mutual respect and well-established rules. If that appears to be the case, there will probably be work for one or two additional transatlantic task forces.

**Connecting Europe and America with the Rest of the World**

Europeans and Americans have long considered themselves at the center of the economic universe, and a snapshot of current economic activity would bolster that view. But a moving picture of economic developments in Africa, Asia, and Latin America suggests that the future may lay outside the transatlantic region and gives new urgency to EU and U.S. efforts to deepen their own economic ties. Moreover, Brussels and Washington need to redouble their efforts to broaden their trade, investment, and foreign aid relations with the developing world, and to strengthen the rules of international commerce and the framework for global financial governance.

Commercial markets and resultant economic power are shifting outside the transatlantic economic space. Based on market exchange rates, the developing nations’ share of world GDP is still small, roughly a third of the total in 2007, up from a quarter in 1990. But, as a group, developing nations have already achieved economic parity with the developed world, when measured by their purchasing power. By this metric, they accounted for 45 percent of world output in 2007, up from 39 percent in 1990. The role of the consumer of first resort is slowly being passed from Europe and the United States to millions and eventually billions of consumers in the developing nations, fueled by the appetites of the emerging middle classes of China, India, Brazil, Turkey, and others. In China alone, the urban middle class—that group of people earning between $3,000 and $12,000 per year and thus able to afford a larger apartment, fill it with appliances, and own a family car—will number over 600 million people by 2025, nearly twice the current U.S. population. As a result, developing nations, which accounted for 41 percent of global imports in 2007, will consume more than half of all imports by 2025.

In 2010, the OECD expects the economy of the euro area will not grow at all and that the United States will grow by only 0.9 percent. Meanwhile, the economy of the world as a whole will expand by 2.3 percent, spurred on by growth of over 9 percent in China and over 7 percent in India. Europe and the United States need the economic dynamism of emerging markets to help them reverse the current economic downturn and to bolster their long-term growth prospects.
The sheer size and dynamism of their markets will also place developing nations, especially China, in the middle of global economic policy debates. The value of their currencies and their international surpluses and deficits will affect European and American interests as never before. Their rules and regulatory regimes, which can encourage or deter imports and can establish technological standards that shape markets, will no longer be purely a domestic matter. Moreover, spurred by strong domestic economic growth and consumers with money to spend, new, competitive corporate players will emerge from the developing nations, challenging many U.S. and European firms in a number of sectors, including autos, pharmaceuticals, telecommunications, banking, steel, and capital goods.

The rise of the developing nations presents significant opportunities and risks for the transatlantic economy. Globalization will be less centered on the United States and Europe. The biggest winners from globalization will be those nations that can best align their interests with this less Western-centric economy.

In the non-transatlantic area, China is by far the most important emerging market economy. It is already “factory to the world.” Chinese workers now assemble or manufacture 70 percent of the world’s toys, 60 percent of its bikes, half its shoes, one-third of its luggage, half of the world’s microwave ovens, one-third of its televisions and air conditioners, and one-quarter of its washing machines. Based on long-term growth rate forecasts, China can expect to grow by 6 percent per year until 2025. At that pace, China’s economy should be larger or equivalent in size to the United States and Europe well within 20 years. And, by 2025, China’s share of world GDP (on a per capita spending power basis) will be roughly equal to the United States and slightly larger than that of the European Union.

China affords both Europe and the United States important trade opportunities, and it poses serious trade challenges. In 2008, a third of the United States’ merchandise trade deficit, $268 billion, was with China. And four-fifths of the European Union’s trade deficit, 164 billion euros, was with China. Thanks in part to these massive surpluses with the transatlantic area, China built up a huge current account surplus with the world, contributing to the financial instability that brought on the 2008 economic crisis. And, in 2009, the weakening of the Chinese yuan against the euro and the failure of the yuan to appreciate against the dollar has slowed the rebalancing of the global economy.

China has also become a major trading player in Africa, long considered the preserve of U.S. and European interests, and the second-largest single buyer of African exports. China has also emerged as a major player in Latin American commerce. Since 2000, China’s two-way trade with Brazil has increased from $1 billion to $48 billion. It is little wonder then that concern in Europe and the United States about China is increasing, with a majority of Americans, French, and Germans and a plurality of Spanish and British now thinking that China’s growing economy is a bad thing.

Most immediately, trade frictions are rising. The United States has brought seven dispute settlement cases against China in the World Trade Organization, as many as Washington has filed
against any nation since Beijing joined the WTO in late 2001, and the European Community has initiated two such actions. China, for its part, has filed four cases against the United States. Moreover, since 1995, the European Community has filed 6 antidumping cases against China, while the United States has filed 16 such cases. For both the European Union and the United States, China has been the second most frequent target of these actions, trailing only India.

Future points of potential friction extend beyond trade, however, and can result in significant and aggravating political spillovers. China’s continued dependence on imported oil and other commodities, for example, is likely to lead to an ever more assertive expansion of its overseas assets, which could be perceived as challenging to American and European interests.

In their trade relations with other nations of Africa, Asia, and Latin America the United States and the European Union offer a variety of preferential trade programs, including the U.S. African Growth and Opportunity Act and the European Union’s “everything but arms” initiative. In 2007, these contributed to the European Union buying nearly a third of sub-Saharan Africa’s exports and the United States taking more than a quarter of what Africa had to sell.

The European Union and the United States also have negotiated or are finalizing preferential trade agreements with emerging market economies: Brussels with South Korea, India, and the nations of Southeast Asia; Washington with Panama, Colombia, and South Korea.

Existing agreements cover a wide range of topics, some building on tariff cuts or commitments on investment, capital movement, and intellectual property rights that nations have already made in negotiations at the WTO—and some that go beyond existing commitments, such as new obligations with regard to competition policy, labor rights, and environmental protection. In the latter category, among those new commitments that are legally enforceable, all deal with regulatory issues, suggesting that both Brussels and Washington use preferential trade agreements as a means of exporting their own regulatory approaches to their free trade partners.

There are also many differences between the approach the European Union and the United States take toward liberalizing trade with the developing world. Brussels uses trade agreements to promote its views on how its trading partners should run their countries. Washington’s preferential trade agreements—with Mexico, Central America, Morocco, and others—include relatively few noneconomic provisions. But the United States makes sure that whatever clauses it adds, be they on labor or the environment, serve America’s perceived interests and are enforceable.

European and American approaches to foreign aid also differ in ways that are counterproductive and ineffectual. There is wide disparity in levels of foreign assistance. In 2008, the United States delivered 0.18 percent of its gross national income as foreign aid. Members of the European Union provided more than twice as much, 0.42 percent. Both of these contributions fell far short of the 0.7 percent international goal for foreign aid. Even when their commitment to development is measured more broadly—by trade, investment, migration, security assistance, and other policies—European nations tend to do better than the United States, but none does very well. And
U.S. and EU trade policies relating to biofuels and genetically modified organisms can indirectly and unintentionally impact the interests of developing nations.

The disbursement of assistance often is a hodgepodge. Europe gives preference to former colonies. The United States has begun to favor dedicated funds to target specific needs, such as the President’s Emergency Plan for AIDS Relief (PEPFAR). Specialization in niche aid capabilities has come about informally, depending on who excels, for example at water projects or health. And the United States has attempted to introduce greater accountability through the Millennium Challenge Corporation.

Washington also tends to give program assistance for specific projects to heighten accountability. Europeans provide recipient nations with budget support, writing a check and then letting the recipient government do the procurement and implementation. Both approaches have their merits, but dealing with conflicting styles and objectives is a nightmare for poor countries in Africa, Asia, and Latin America.

In the context of these observations, we offer the following recommendations:

- In recent years Washington and Brussels have worked closely on WTO cases involving China. Such cooperation should be extended to a range of other issues, including exchange rate management, technological standard setting, and health and safety of imports. Whenever feasible, the United States and Europe should work together in dealing with China and other emerging market economies such as India and Brazil.

- Brussels and Washington are likely to continue to negotiate preferential free trade agreements with nations in the developing world. To avoid inconsistencies between deals, to ensure consistency with multilateral trade rules, to avoid having a negotiating partner play the European Union off against the United States, and to maximize the trade liberalization from such accords, the European Union and the United States should more closely coordinate their negotiating strategies with, for example, Brussels possibly focusing on nontariff barriers in the manufacturing sector, while Washington focuses on the service sector.

- The European Union is currently negotiating a free trade deal with India. India says it wants a free trade accord with the United States as well. Simultaneous U.S. and EU free trade negotiations with South Korea created momentum toward greater liberalization. Washington should consider parallel negotiations with India to ensure that a separate Brussels deal with Delhi does not set a ceiling for what the United States could eventually get from India. The United States, the European Union, and India should explore the desirability of a single plurilateral, rather than separate bilateral, negotiations.

- The United States and the European Union have both promised to halt agricultural export subsidies and to provide duty-free, quota-free access to all products from the least-developed countries as part of a final deal in the Doha Round of multilateral trade negotiations. Since those talks may still take years to complete and the offer of such concessions has provided no
leverage in the negotiations, Brussels and Washington need to provide the poorest nations of Africa, Asia, and Latin America with these benefits immediately.

- Reconstruction of failed states, such as Afghanistan, is an ongoing challenge for both the United States and Europe, and that effort has largely fallen to the military on both sides of the Atlantic for want of a civilian capacity to rebuild strife-torn countries. Rather than separately developing that civilian reconstruction capability—sanitation engineers, police trainers, health care and education specialists—Brussels and Washington should develop and exercise this expertise jointly.

- The United States and European Union should adopt the Millennium Development Goals and judge aid effectiveness by progress toward meeting those goals, jointly end the tying and earmarking of aid, maximize the use of local procurement and develop common standards for accounting and measurement of success.
About the Authors

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