

Second Conference on North America, Germany and Asia
Atlantik-Brücke / Pacific Council on International Policy

March 30 – April 1, 2006, Berlin

**"Europe, the United States and Transatlantic Relations:
Strategies for Shaping the 21st Century World"**

Dr. Heinrich Kreft¹

Senior Strategic Analyst, Policy Planning, Federal Foreign Office, Berlin

For over half a century the alliance between Europe and the United States has been a key force for global economic and political progress. Today, however, as storm clouds loom not only over transatlantic relations but also developments within Europe and the Americas, it is both timely and critical to examine the interactions between regional integration and transatlantic relations as well as the broader roles of Europe and the U.S. in the world.

Headway on European integration has ground to a halt. Europe's core major economies are stagnating. Its citizens hold the European Union to blame for everything from unemployment to ethnic tensions. Similar problems can be seen in the Americas, albeit in a very different context. In the U.S. immigration from Mexico and other Latin American countries is a hot button issue. In Latin America the rise of an anti-globalization and anti-American brand of left-wing populism has the potential to destabilize the region and seriously damage relations with the United States.

Aside from these regional problems, there is no doubt that transatlantic relations themselves are in flux. While tensions over Iraq have eased somewhat, it is still not clear in what direction U.S.-Europe relations are heading. New leaders are or soon will be in place in key European capitals and there is a real prospect that member states could revoke the EU's authority to act particularly in the field of foreign and security policy. Within the U.S. elite and popular attitudes to Europe remain dominated by perceptions formed in the run-up to the Iraq war.

There are also broader global challenges confronting Europe and the U.S., including Islamic extremism, nuclear proliferation and the re-emergence of Asia as an economic giant. How Europe and the U.S. respond to these challenges, and whether they do so separately or in partnership, will have a profound impact on the course of the first decades of the 21st century.

This second joint Atlantik-Brücke/Pacific Council workshop once again brought together prominent Europeans and Americans well placed to analyze the challenges and opportunities facing these key allies as well as to suggest productive ways to further their shared aspirations for peace, prosperity and freedom.

¹ These reflections draw on the very interesting discussions at a workshop held in Berlin from March 30 – April 1, 2006, which brought together Germans and Americans under the auspices of the Atlantik-Brücke, Berlin, and the Pacific Council on International Policy, Los Angeles. The workshop participants should be credited with any useful insights in these reflections but spared identification with any shortcomings.

Après Non: The Future of the Integration Process

Both European and American participants agreed that the European Union is currently in trouble. The present crisis is due to the French and Dutch "no" to the proposed Constitution for Europe, although only 19% of French voters rejected it because they saw it as threatening French identity (in the Netherlands the figure was 26%). To find a way out many are looking to the German Presidency in the first half of 2007, when the EU will also be celebrating the fiftieth anniversary of the signing of the Rome Treaties. That would be a good opportunity not only to look back with a certain pride at what has been accomplished but also to tackle with fresh courage the constitutional problems that urgently require a solution. This could prove complicated, however, especially in the light of the French presidential elections due in early summer 2007.

Of course European integration has suffered setbacks in the past and they have always eventually been overcome. Strenuous efforts to settle this vexed question are needed now, too, for otherwise there may for the first time be a real danger that the progress Europe has already achieved on integration might actually be reversed. In that case such capacity for political action as the European Union already has could be lost and it could become nothing more than a large and diffusely organized European free-trade zone. Since the French and Dutch "no", the EU has nevertheless demonstrated that it still has the ability to act. It succeeded in reaching agreement on the Financial Perspective and over the Services Directive, too, a viable compromise was found that duly balances the requirements of the internal market against the need for a fair give-and-take between all sections of society. At their recent summit on energy EU leaders likewise showed that Europe has the capacity to develop a joint strategic response to major issues on the agenda. The shared goal of EU members remains clear: to build a Europe that can act effectively both internally and externally and be a role model also for regions well beyond Europe's borders.

Foreign and defense policy is a field that has acquired increasing importance for the EU over the years. Since the EU cannot for ever depend on the U.S. to defend it, it needs to develop its own common defense. While it has considerable non-military resources, it still lacks sufficient military resources. Many countries are keen to join the EU (and NATO), although there is now widespread resistance within the EU to the prospect of any further enlargement beyond Rumania, Bulgaria (and the Balkans).

In a more recent development, the European Security and Defence Policy (ESDP) initiated at the Cologne European Council in June 1999 is likewise becoming more important. In December 2000 the Nice European Council agreed that new structures based in Brussels were needed to strengthen the Common Foreign and Security Policy (CFSP) and develop the ESDP. At the same time the Council paved the way for the EU and NATO to begin cooperating on crisis management operations across the full range of "Petersberg tasks" (humanitarian and rescue tasks, peacekeeping and crisis management operations, including peacemaking). Under framework arrangements concluded in March 2003 ("Berlin plus"), the EU is now able to draw for this purpose on NATO assets and capabilities. Since 2003 the ESDP has also had a civilian crisis management dimension. Under ESDP auspices some 11 military and civilian crisis management operations and missions have been launched to date. The rationale for the development of ESDP capabilities is to enable the EU, in partnership with international organizations such as OSCE and the United Nations, to make a European contribution to peacekeeping missions around the world. Accordingly, the EU and the United Nations approved in September 2003 a joint declaration on cooperation in the field of crisis management.

The development of the ESDP received a further strong boost with the inclusion of a so-called solidarity clause in the draft Constitution for Europe. In response to the terrorist bombings in Madrid in March 2004, EU members committed themselves in a politically binding declaration to apply the clause with immediate effect. In June 2004 the European Council adopted the Headline Goal 2010 and in the same year the European Defence Agency commenced operations. In December 2004 the European Council approved detailed proposals for planning and coordinating joint European operations (EU operations center, EU planning cell at SHAPE and NATO liaison officers based with the EU Military Staff). The Civilian and Military Cell has been operational since 2005.

Still today little, too little, is known about the EU in the U.S., even inside Congress and the administration. The focus of U.S. attention is increasingly shifting away from Europe towards China, Asia in general and the broader Middle East. Yet Europe and the U.S. continue to be very important to each other. Together they account for 60% of the world's GDP. One million Californians work for EU companies, U.S. investment in Denmark alone is higher than in India. European companies have invested heavily in the U.S. and vice versa. It therefore came as a big surprise to General Electric when the EU blocked its planned purchase of Honeywell, a move which prompted it to move its European headquarters from London to Brussels. The U.S. and Europe face many of the same challenges, from terrorism and global poverty to climate change and the effects of growth or lack thereof. They continue to need each other – and the rest of the world wants them to realize this and act accordingly.

Regional Integration in Europe and the Americas

There are of course significant differences between regional integration in Europe and the Americas, including the fact that integration in Europe is considerably more advanced. While the European venture has from the start been a political project which has also been highly successful economically, the situation in Latin America is very different. There integration has been a response to advice from Washington ("Washington Consensus") to democratize, privatize, end hyperinflation and adopt pro-integration policies. Despite problems with corruption and strong labor unions, Latin American markets are now relatively open and financial liberalization has allowed big inflows and outflows of capital. Over the past 25 years much has been achieved at the macroeconomic level, but the bulk of the continent's citizens are unhappy with the results. While they were prepared to accept short-term pain for long-term benefits, many have seen no benefits at all. This is due mainly to a shortage of foreign direct investment (FDI) and the fact that FDI flows have often not been invested in the most productive sectors. The prime reasons for this are the lack of strong property rights and endemic failure to uphold the rule of law.

Thanks to the internal market and substantial assistance programs, the EU has been notably more successful in promoting regional integration. The EU's southern enlargement to include Spain, Portugal and Greece resulted in sustained high growth in these countries and enabled them to rapidly narrow the economic and social gap between them and older EU members. Whereas in 1975 Spain and Mexico were in many ways similarly backward, Spain has now shot up the economic ladder, a success it undoubtedly owes to the EU. The free-trade-only approach with which the U.S. has sought to impose market forces on Latin America stands in marked contrast to the EU approach. By adopting the *acquis communautaire* – the entire body of EU law – the new EU members have become part of a real community. This has been a

crucial factor e.g. in boosting FDI, since investors can rely on property rights in these countries being fully protected, something that is far from the case in Latin America.

Although there is certainly growing uneasiness in many EU countries at the prospect of further EU enlargement, enlargement is set to continue. Romania and Bulgaria will join the EU probably at the beginning of 2007 and at the latest on January 1, 2008. Accession negotiations are under way with Turkey and Croatia. While Turkey clearly needs a European perspective, it is by no means certain, given the recent setbacks, that the country will succeed in pushing through the required reforms and thereby qualifying eventually for membership. There can be no doubt at all, however, as to Turkey's strategic importance for Europe.

The EU remains attractive for countries outside the Union, which is certainly a good thing for Europe. But an enlarged Europe must also be able to act more effectively. That was the whole purpose of the European constitution. Clearly a way must be found to unblock the stalled constitutional process and make an enlarged EU work. The aim is not an empire or some kind of super state but an ever closer Union in partnership with the United States. Could such a Union serve as a model for Latin America or even Asia?

The Asian Challenge

The rise of China and India as well as Asia in general was discussed at great length, highlighting how seriously the Asian challenge is viewed on both sides of the Atlantic. Historically speaking, as participants pointed out, power shifts between countries and regions have rarely been peaceful and are inevitably attended by political and cultural changes. In the light of its growing economic strength, it is only to be expected that Asia should demand a greater role in international institutions and fora.

The emergence of China and India as major new global players is set to transform the whole geopolitical landscape. The mega trend of our time is globalization and China is right at the center of it. India will join it there soon. Managing the peaceful rise of China is the biggest challenge ahead for Asia and the whole world. In the eyes of many Chinese, the Middle Kingdom is now back center-stage, occupying its rightful place in the world as it once did for all of 2000 years. In 1800 China's share of global GDP was around 30%; now it is 6% and the Chinese government is aiming for 20% by 2015.

Within a single generation, per capita income has increased eightfold. And more than 300 million people have been lifted out of poverty. Over the past two decades China has transformed itself from one of the world's most backward and inward-looking countries into its largest consumer of natural resources and an export power-house. Since 1985 China's foreign trade has increased by 15% a year and now exceeds one trillion euro. Some 40% of Airbus sales, for example, are now going to Asia and above all to China, which will need 1,500 new aircraft over the next 10 years. The country also holds the world's second largest reserves of foreign exchange valued at over 800 billion euro, much of it in US Treasury Bills, thus making the US technically in debt to China.

Today China has in fact a more open market than either South Korea or Japan. For that reason China is the top destination for FDI, which now totals over US\$ 500 billion. The country is already the world's leading producer of manufactured goods, accounting for 12% of global output. Its economic success has consequences of course in other areas as well. Now that it can afford higher military expenditure, China is spending more on military hardware and has

launched its own space program. Its impressive economic growth also serves to promote its foreign policy interests in Asia and beyond. Its relations with Japan, however, remain troubled. How the relationship between these two countries evolves over the years ahead was seen by participants as having a critical impact on peace and stability in the entire East Asia region. While China was the stronger of the two for about 2000 years, over the past 200 years it was the other way round. And now they are about to enter a historically new phase, in which both are strong at one and the same time. Participants agreed it was vital that the U.S., Europe and others should do everything possible to help these two countries to get along with one another.

Despite its successes, China's economic growth remains vulnerable for a number of important reasons. Its financial system is fragile. Tens of million of Chinese workers still work in old state-owned enterprises, most of which have been making losses for years. The problem of corruption is endemic and has far-reaching economic and also political repercussions. The country needs to deal with huge environmental problems caused by air and water pollution. Its drinking water security is seriously at risk. HIV/AIDS and other highly infectious diseases like SARS and bird flu constitute further threats. China is becoming rapidly dependent on energy imports (oil, gas, uranium).

The biggest problems, however, are unemployment, enormous regional imbalances and severe poverty particularly in the countryside, which are leading to growing social unrest. According to Chinese figures, there were 65,000 incidents of unrest in 2004 alone and even more last year. Cross-strait relations remain fraught, making Taiwan probably the most dangerous hot spot in Asia. Finally, there is the challenge of a developing but at the same time aging society. Whether the Communist Party, whose credibility and legitimacy is fast eroding, will continue to provide stability and development in the future remains to be seen. If China fails to address these problems effectively, it might not become as strong as many anticipate today.

According to most indicators such as overall GDP, FDI and per capita income, India continues to lag behind China. China's per capita GDP is now 2.2 times higher than India's (in US\$ PPP terms). Up to the early 1990s per capita GDP in China and India was at roughly comparable levels, but China adopted wide-ranging economic reforms more than a decade before India followed suit. Through trade and investment the Chinese economy is also much more closely integrated into the world economy, which helps explain its higher rate of GDP growth over most of the past three decades. To boost economic development China has relied on industry, whereas India has focused on services. China's ratios of domestic savings and investment to GDP are roughly twice those of India. Both currently have a strong external position with substantial foreign exchange reserves. As a percentage of GDP they both have low external debt and a low ratio of short-term external debt to foreign reserves. Despite declining fiscal deficits, the level of public-sector debt is of course of concern, especially in India.

Surveys indicate that India has higher standards of corporate governance and its companies are more commercially-driven. It also has functioning capital markets and more world-class companies in a number of high-tech sectors. This explains why, despite China's superior economic growth and macroeconomic stability, India's rate of return on assets has been much higher, the proportion of non-performing loans in the banking system lower and stock market performance much better.

The fact that China started earlier than India to liberalize its economy and invest heavily in modernizing its physical infrastructure has given it a substantial edge over India in terms of per capita income. This head start has also made China a more attractive FDI destination. However, although India launched its economic reforms a decade later than China, it is far more advanced in terms of institutional infrastructure and corporate governance. This is reflected in contrasting outcomes: while FDI in India is considerably lower than in China, returns on investment are generally higher. Since India clearly has the potential to rival China as an FDI destination, what is needed to tap this potential is a determined effort by the Indian authorities to push ahead with reforms.

Another of India's assets are its well-established democratic institutions, which make the country somewhat less vulnerable to political instability. While India's working-age population will continue to grow, China will have to deal with the problems of an aging society. India still needs to get rid of stifling bureaucracy and has a much higher percentage of its population living in poverty than China.

Most experts expect economic growth in China to slow over the next couple of years owing to a host of growth-limiting factors such as environmental degradation, infrastructure deficits, energy shortages and so on, while India stands a good chance of accelerating its growth. Under these circumstances it is quite possible that India will overtake China in growth terms over the next few years.

The Asian challenge has to be accepted and we have to make sure that it is and remains a win-win-game both for the Asians and for us. China should be urged to become a responsible stakeholder of the international community, as U.S. Deputy Secretary of State Bob Zoellick has put it. Clearly it is important that Europe and the U.S. should also deepen and broaden their dialogue on China. Opportunities for cooperation with China, India and other Asian countries exist in a host of different fields.

Common Enemies, Different Strategies? European and American Responses to Security Challenges

Iraq is by far the greatest security challenge facing the U.S. and could become one for Germany, too, even though it opposed the war. The costs of the war in Iraq are multiple, massive and steadily increasing. Besides the horrific blood toll (2,350 U.S. soldiers killed, 18,000 wounded and 35,000 Iraqis killed), the financial cost is extremely high (\$60–100 billion per year) in terms of the U.S. foreign affairs budget of \$35 billion, but in terms of its \$450 billion defense budget not necessarily unsustainable. Other costs are similarly substantial and strategically significant. In deciding to go to war the U.S. risked a breach with "old Europe". The rifts thus incurred have yet to be fully repaired or overcome, although since Angela Merkel's arrival in the German Chancellery direct communication between Washington and Berlin has been re-established at the highest level. In Europe and other parts of the world, the war has cost the U.S. a huge amount of good will ("soft power"). It has also noticeably reduced U.S. leverage in dealing e.g. with Iran and/or North Korea.

The Bush Administration's "strategy for victory" relies at its core on building up and empowering Iraqi forces as well as obtaining further multilateral assistance. The first goal appears to be steadily elusive, if not increasingly impossible, and it is equally hard to imagine any substantial multilateral assistance being offered. If the US cannot get the job done with all

its military might, how could limited outside help e.g. from Germany make any difference now? Although there are few political incentives for Germany or other opponents of the war to become more closely involved in Iraq and thus water down their original "no", Germany has nevertheless increased its financial support and expanded its training programs for Iraqi police officers.

Grim though the current situation is, on the other side of the strategic ledger are the possible consequences of a total fiasco in Iraq, ranging from general instability throughout the Middle East to the dangers arising from a failed state and the disruption of energy supplies, all of which would severely compromise national security in Germany and Europe as a whole. If substantial outside help is not forthcoming and stabilizing Iraq remains an elusive goal, an American defeat – in the form of a troop withdrawal that leaves Iraq less than unified, pacified and secure – cannot be ruled out. Public opinion in the U.S. has already begun to shift in that direction. Such a defeat would have momentous repercussions not just in the Middle East. America's status as the world's only superpower would be threatened and its credibility as an international actor called into question. While some in Europe (and elsewhere) believe this could result in greater American humility regarding the U.S. role in the world, it could equally well result in considerable domestic turmoil in the U.S. as well as dramatic policy changes on a range of international issues. Following a defeat in Iraq there is therefore a high likelihood that the U.S. will be an uncomfortable and difficult partner for some time to come. Preparing for such an eventuality and dealing with it should it arise could turn out to be one of the most difficult strategic challenges facing America's partners and allies around the world.

Of course there are many more challenges besides Iraq. One of them – and currently the most urgent one – is Iran. Cooperation between the U.S. and the Europeans on Iran is very close and has helped restore confidence in the transatlantic partnership. Other items on the transatlantic agenda for 2006 include the final status of Kosovo and the Israel-Arab conflict in the wake of the Hamas election victory. There is also the broad question of how to further modernization and democratization throughout the Arab/Islamic world and beyond. With the Doha Round on the brink of failure, another challenge is how to strengthen free trade in the face of growing protectionist tendencies in the U.S., Europe and elsewhere. High oil prices as well as Russia's cut-off of gas supplies to Ukraine (and Western Europe) in January have put energy security high on the agenda in Washington, Berlin, Beijing and other capitals.

International terrorism is as much a threat to Europe as it is to the U.S. and in the future, too, combating it will call for a joint response. Europe provides the only true political and also military partners the U.S. has. The Europeans – and Germans in particular – want the U.S. to remain in Europe and they also want a healthy transatlantic relationship. The U.S. experience in Iraq has probably ended its appetite for "muscular unilateralism" for some time to come. Washington has taken steps to improve its relations with Europe and is keen for the EU to become a more effective player in the global arena. If Europe can overcome its current crisis and preoccupation with itself and learn to be more proactive in international affairs, this could pave the way for a lasting "re-rapprochement" between Europe and the United States.