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Transatlantic relations and the global economy

Peter B. Kenen*

Department of Economics, Fisher Hall, Princeton University, Princeton, NJ 08544, USA

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Abstract

An Atlantic partnership has served for half a century to foster economic cooperation, but it is at risk today. This paper examines the reasons, including the growing importance of Asia, the changing nature of the economic problems facing the Atlantic partners, and limits on the scope for policy coordination resulting from changes in views about the best use of key policy instruments. The paper then proposes institutional reforms: The G-7 Summits should be replaced by informal meetings between leaders of the industrial countries and those of systemically important developing countries. European representation in the IMF should be consolidated, and the Fund's Executive Board should be reorganized.
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1. Introduction

For fifty years after the Second World War, an Atlantic partnership served three key purposes. First, and most importantly, it committed the United States to defend Western Europe against the perceived threat from the Soviet Union. The North Atlantic Treaty Organization (NATO) was thus the pre-eminent manifestation of the partnership. While NATO survives, it does not now serve any comparable purpose.

Second, the Atlantic partnership committed its members to the maintenance of open markets and progressive trade liberalization. Although the General Agreement on Tariffs and Trade (GATT) had important 'outside' members, such as Japan, agreement between the United States and the European Union (EU) was necessary and nearly sufficient for a successful GATT negotiation.

* Tel.: +1 609 258 4051; fax: +1 609 258 6419.
E-mail address: pbkenen@princeton.edu (P.B. Kenen).

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Third, the Atlantic partnership committed its members to the collaborative management of the international monetary system, including the occasional coordination of their own national policies. The evolution and operations of the Bretton Woods institutions, the International Monetary Fund (IMF) and the World Bank, have indeed been managed by a transatlantic condominium.

These observations are not meant to imply that the partnership has been wholly harmonious. There have been major disagreements about systemic issues, such as those that surrounded the collapse of the Bretton Woods exchange rate regime. There have been many transatlantic trade disputes. And there have been large variations in the nature and intensity of monetary cooperation, defined to include macro-policy coordination as well as exchange rate management. I will say more about that shortly. By and large, however, cooperation between the Atlantic partners has served to sustain and adapt the rules and arrangements that governed the global economy during the second half of the twentieth century.

Why, then, do many fear that the Atlantic partnership is at risk today? It is tempting to blame the new unilateralism of the United States, and I am deeply worried by it—not merely for the damage it has done to the Atlantic partnership, but also for the damage it has done to the influence and security of the United States itself. But this is not the place to dwell on that matter, although it impinges pervasively on the issues I will discuss. Furthermore, the new unilateralism does not account completely for the perceived and actual decline in the cohesion of the Atlantic partnership. Other forces are at work.

2. Four hypotheses

Let me propose and weigh four explanations for the decline in the cohesion of the Atlantic partnership.

(1) *Asia has become more important economically to the United States and Europe has become less important.* I thought initially that this might be one of the principal reasons for the diminishing prominence of the Atlantic partnership. The numbers, however, do not say so clearly.

Consider the data in Table 1. Comparing 1990 and 2002, we find that the shares of the EU and East Asia in U.S. exports and imports have both fallen, but East Asia accounted in both years for a larger share of total U.S. imports and, by 2002, for more of its exports. Turning from trade to direct investment, we find that the shares of the EU and East Asia in the direct-investment assets of U.S. firms have both risen, and the share of the EU is still much larger, but the share of East Asia has grown faster. Finally, the share of East Asia in world currency reserves has doubled, surpassing hugely the share of the EU, and these reserves consist in large part of dollar claims on the United States.

The memorandum to Table 1 shows why the shares of the EU and East Asia in U.S. trade have fallen since 1990. The combined shares of Canada and Mexico have risen sharply, and Table 2 shows what happens when we exclude those countries' data from the global totals of U.S. exports, imports, and direct-investment assets. The share of East Asia in Non-NAFTA U.S. exports has risen absolutely, whereas the share of the EU has fallen absolutely. But the share of East Asia in Non-NAFTA U.S. imports has not changed, whereas the share of

Table 1
Transatlantic and transpacific linkages, 1990 and 2002

Item	1990	2002
Percentage share of U.S. exports		
European Union	26.3	20.7
East Asia	26.7	24.3
Percentage share of U.S. imports		
European Union	20.0	19.4
East Asia	36.9	34.3
Percentage share of U.S. FDI stock		
European Union	42.7	46.0
East Asia	10.6	14.6
Percentage share of world currency reserves		
European Union	38.5	13.0
East Asia	22.5	48.7
Memorandum on shares of NAFTA partners		
Percentage share of U.S. exports	28.3	37.3
Percentage share of U.S. imports	24.1	29.6
Percentage share of U.S. FDI stock	18.5	13.8

Sources: U.S. Department of Commerce and International Monetary Fund. *Notes:* East Asia comprises China, Hong Kong, Indonesia, Japan, Malaysia, The Philippines, Singapore, South Korea, Taiwan, and Thailand (but Taiwan is omitted from holders of currency reserves).

the EU has risen. And the share of East Asia in Non-NAFTA direct-investment assets has risen faster than that of the EU, although it is still smaller absolutely.

These numbers, of course, are backward-looking, and one can safely say that East Asia, especially China, will become increasingly important to the United States during the next decade. So, too, will India. The numbers, however, do not explain or justify what has already happened—the decline in the importance of the Atlantic partnership.

(2) *The partnership can no longer contribute decisively to the resolution of its members' urgent problems*. In the United States, of course, the threat of terrorism commands urgent attention, and the defense against it calls for close cooperation with other countries—but

Table 2
Transatlantic and transpacific linkages adjusted by omitting NAFTA partners from U.S. totals, 1990 and 2002

Item	1990	2002
Percentage share of U.S. Non-NAFTA exports		
European Union	36.7	33.1
East Asia	37.3	38.7
Percentage share of U.S. Non-NAFTA imports		
European Union	26.3	27.6
East Asia	48.7	48.7
Percentage share of U.S. Non-NAFTA FDI stock		
European Union	52.4	53.4
East Asia	13.0	17.0

Sources: U.S. Department of Commerce and International Monetary Fund. *Notes:* East Asia comprises China, Hong Kong, Indonesia, Japan, Malaysia, The Philippines, Singapore, South Korea, Taiwan, and Thailand.

not just the EU countries. In Europe, the challenges of eastward enlargement and of EU governance have demanded much attention, along with the need to address obdurate domestic problems, including the need for pension reform and for more flexible labor markets. Even in the macroeconomic sphere, a traditional domain of the Atlantic partnership, the largest problems call for domestic solutions, especially fiscal consolidation, rather than policy coordination, and this brings us to another explanation for the decline of the partnership.

(3) *There has been a major change in views about the efficacy or proper use of certain policy instruments*. For good and bad reasons alike, the discretionary use of fiscal policy has fallen out of favor—although advocates of the recent U.S. tax cuts have now clothed them belatedly in an old-fashioned Keynesian costume. Furthermore, the conduct of monetary policy is entrusted to independent central banks, and they have adopted targets and tactics that do not readily lend themselves to policy coordination. There are thus fewer instruments available for policy coordination, even if national policymakers were still inclined to pursue that strategy.

Most importantly, there is today little if any official enthusiasm for exchange rate management. In the case of the euro zone, moreover, there is no firm fixing of responsibility for exchange rate management. It is divided between the European Central Bank and the EU Council of Ministers, hovering somewhere between Frankfurt and Brussels.

At the same time, policymakers who used to focus on these matters have been otherwise engaged—in managing emerging-market crises and building better defenses against them.

Finally, the many new problems facing the Atlantic partners and, indeed, the whole world, are different in nature and complexity from those they used to tackle. Some, such as problems posed by demographic trends, require major changes in national regimes. Others, such as global warming, terrorism, and disease, cannot be addressed by national governments individually but cannot be addressed by the Atlantic partners without the active cooperation of other countries' governments.

To assess the impact of these changes in the uses of policy instruments and in the nature of the problems facing the Atlantic partnership, I reread the communiqués issued by four G-7 Summits—the ones that met in German cities between 1978 and 1999—and was struck by the extent to which the communiqués have changed. I reproduce in Boxes 1 and 2 extracts from the first and last of those communiqués, the ones issued at Bonn in 1978 and at Köln in 1999.

At Bonn, in 1978, the heads of government of the G-7 countries focused on the problem of unemployment and sought, therefore, to stimulate economic growth, but to do that in a way that would also reduce current-account imbalances and thereby contribute to exchange rate stability. Therefore, they agreed on a collective strategy, but one to which each country would contribute in a manner appropriate to its own national situation. Germany, for example, agreed to adopt a strongly stimulative fiscal policy, and the United States agreed to reduce its dependence on imported oil and make sure that domestic oil prices would soon rise to world levels. The Bonn communiqué also drew attention to the damaging effects of "erratic" exchange rate fluctuations and said that the G-7 countries would intervene in foreign exchange markets when necessary to combat disorderly conditions.

Box 1. The 1978 Bonn Summit

The communiqué begins with this statement:

We are concerned, above all, about worldwide unemployment, because it has been at too high a level... We will act through measures to assure growth and develop needed skills, to increase employment... But we need an improvement in growth where that can be achieved without rekindling inflation in order to reduce extremes of balance of payments surpluses and deficits. This will reduce destabilizing exchange rate movements ...

A program of different actions by countries that face different conditions is needed to assure steady noninflationary growth. In countries whose balance of payments situation and inflation rate do not impose special restrictions, this requires a faster rise in domestic demand. In countries where rising prices and costs are creating strong pressures, this means taking new measures against inflation.

The communiqué then lists the actions to which each government has committed itself. For example:

... the German delegation has indicated that... it will propose to the legislative bodies additional and quantitatively substantial measures up to one percent of GNP, designed to achieve a significant strengthening of demand and a higher rate of growth.

For its part, the United States undertook to reduce its dependence on imported oil and make sure that U.S. oil prices would soon rise to world levels.

Furthermore, the communiqué concludes with commitments about exchange rate policy:

The erratic fluctuations of the exchange markets in recent months have had a damaging effect on confidence, investment and growth throughout the world. ... Implementation of the policies described above in the framework of a concerted program will help to bring about a better pattern of world payments balances and lead to greater stability in international exchange markets. This stability will in turn improve confidence and the environment for sustained economic growth.

Although exchange rates need to respond to changes in underlying economic and financial conditions among nations, our monetary authorities will continue to intervene to the extent necessary to counter disorderly conditions in the exchange markets ...

Source: G-8 Information Centre, University of Toronto (www.G-8.utoronto.ca/summit/index.htm).

At Köln, in 1999, there were two communiqués—a long one issued by the G-8 (i.e., the G-7 *plus* Russia), which covered a wide range of issues, and a short one issued by the G-7, that focused primarily on the world economy. It listed the tasks facing each G-7 government but did not attempt to portray them as a coherent or coordinated program, and it said nothing whatsoever about exchange rates or the international monetary system. It turned instead to other issues, including some that were also covered in the G-8 communiqué.

Box 2. The 1999 Köln Summit

This time, there were two communiqués:

A long G-8 communiqué dealt briefly with macroeconomic and monetary issues, including brief references to the Asian and Russian crises, and went to discuss the trading system, structural reforms to reduce unemployment, strengthening social safeguards, development assistance and debt reduction, environmental issues, the problems of nonproliferation, arms control, and nuclear safety, and a host of "global challenges" such as civil wars, the global spread of AIDS, corruption, and organized crime.

A shorter G-7 communiqué dealt at greater length with the world economy and listed the tasks facing the national governments:

In North America, macroeconomic policy should aim at maintaining the conditions for balanced growth.

In the euro area, it is important to pursue an appropriate mix of macroeconomic and structural policies aimed at strengthening prospects for improved growth and higher employment.

In the United Kingdom, economic policies should continue to aim at fostering non-inflationary growth.

In Japan, it is still essential to implement stimulus measures until domestic demand-led growth is restored and to pursue structural measures to enhance the economy's efficiency and competitiveness.

Thereafter, however, the communiqué turns to other issues—strengthening the international financial architecture, debt relief for the heavily indebted poor countries, nuclear safety, financial crime, harmful tax competition, and international tax evasion. And some of these matters are also discussed in reports submitted to the Summit by the G-7 finance ministers.

But there is no mention of concerted or coordinated action in the macroeconomic sphere, only to the need for "close cooperation to foster worldwide economic growth," and nothing is said about the monetary system or exchange rates.

Source: G-8 Information Centre, University of Toronto (www.G-8.utoronto.ca/summit/index.htm).

The 1978 Bonn Summit is often described as the peak of policy coordination. The 1999 Köln Summit was not the nadir. That dubious distinction probably belongs to an earlier G-7 Summit. But the Köln communiqué was typical of those issued by recent summits.

(4) *Agreement between the Atlantic partners is still necessary but no longer sufficient to sustain or adapt the rules and arrangements of the international economic system*. That is most clearly true in the trade-policy domain. The emergence at Cancun of the so-called G-20, a group of large and small developing countries, put paid to the old-fashioned notion that agreement between the Atlantic partners could define the scope and character of global trade liberalization. But it is also true in other policy domains.

A reduction of the huge U.S. current-account deficit requires an increase of national saving in the United States. The pace and character of the adjustment process, however, will depend importantly on the exchange rate policies of China and other Asian countries. Yet, the Atlantic partners are not ready to concede that solutions to the trade and monetary problems facing the world economy call for major changes in global governance.

We now face on the global stage a problem much like one that used to bedevil trade bargaining within the Atlantic partnership. When the EU came to the bargaining table, it was already bound by a deal struck internally within the EU—a deal that sometimes reflected extraneous side agreements and gave the EU negotiators little if any discretion. They did not always have a well-defined fall-back position, and deadlock often loomed before a bargain could be struck. But something similar occurred in the run-up to Cancun, although the cast of characters was quite different. This time, the Atlantic partners were the ones that agreed on a rigid position, without also agreeing on a fall-back position. They struck a deal on the liberalization of agricultural trade without asking themselves what they would concede during the bargaining process with the rest of the world. They were too used to assuming that other countries would fall into line once the U.S. and EU had resolved their differences, regardless of the way in which they resolved those differences. And when the rest of the world—or a large part of it—rejected their rigidly agreed position, the U.S. and EU were too willing to pick up their marbles and look for another game to play—striking bilateral bargains with much weaker partners.

The Atlantic partnership still has a crucial role to play in fashioning a better, safer world. It cannot do that, however, by making take-it-or-leave-it offers or, in international institutions, retaining *de jure* or *de facto* veto power over the ordinary operations of those institutions. Let me then offer some thoughts on the future of the Atlantic partnership and on the governance of the global economy.

3. An agenda for reform

First, the Atlantic partnership can and should play a major role in the design and conduct of U.S. foreign policy. But NATO and its ministerial meetings are the main vehicle for that purpose. The United States should presumably welcome the willingness of the EU to form and deploy its own multinational force. It should, however, continue to oppose the creation of a wholly autonomous force.

Second, the G-7 Summits no longer serve a vital purpose. They are more show than substance. Russia is half in and half out, so we now have a G-7.5, which issues two communiqués. Last year at Lille, moreover, the heads of the Bretton Woods institutions were granted an 'audience' along with representatives of the developing world. That group was too large and the meeting too short for any meaningful exchange of views, adding strongly to the message that the G-7 Summits are more show than substance. The agenda, moreover, has become too long, covering too many subjects. It may thus be time to replace the summits with regular bilateral meetings between the heads of government of the major industrial countries. Meetings of that sort take place now, sometimes in the context of larger meetings, such as those of the European Council and the UN General Assembly. The result could well

be a small reduction in the number of meetings and, more importantly, a lowering of the high expectations generated by the G-7 Summits.

Third, there is still need for close collaboration among the major industrial countries on a wide range of economic matters. But that can best be achieved by the meetings of the finance ministers that take place before each semiannual meeting of the IMFC—the International Monetary and Financial Committee of the IMF. At Köln, in 1999, and at other recent summits, the reports of the G-7 finance ministers, prepared in advance of the summits themselves, had more operational content and importance than the communiqué.

Fourth, it is essential to give other key countries more stake and more voice in managing the global economy. To that end, a triad of national leaders—the President of the European Council (once he or she has a longer term of office), the President of the United States, and the Prime Minister of Japan—should meet informally with the national leaders of other major countries. The meetings might take place biannually, and there would be an agreed agenda—a short list of subjects to be discussed—but no communiqué and, more importantly, no national press conferences after each meeting. Those meetings should surely include the Presidents or Prime Ministers of Brazil, Canada, China, India, Mexico, Russia, and South Africa, and they might also include the heads of the IMF, World Bank, and WTO.

Finally, I see the need for reform within those three institutions. The WTO badly needs a small executive body. The Fund and the Bank need to reorganize their executive bodies.

I strongly agree with Pascal Lamy that the WTO needs some sort of managing board. All of its 150-odd members must, of course, participate fully in the periodic trade bargaining rounds, as they will be bound by the agreements made in the course of those rounds. But the design of the *framework* for those bargaining rounds—the so-called modalities—should be devised by a smaller body. At one time, that was done in practice by the so-called Quad (Canada, the EU, Japan, and the U.S.). But the breakdown at Cancun showed that prior agreement within the Quad can become an obstacle to broader agreement on the design of the bargaining framework.

It is tempting to suggest that regional trade groups—customs unions and free trade areas—provide the basis for representation in that new smaller body, but there are strong objections to that approach. Too many of the regional groups overlap. The intra-regional ties within those groups do not always reflect their members' stake in the global trading system. (Canada, for example, belongs to NAFTA but its interests as a major agricultural exporter make it a key member of the so-called Cairns Group.) And too many countries, large and small, lie outside existing groups, and using those groups as the basis for representation might give the 'outsiders' an added incentive to form new groups, regardless of their economic merit. Knowing too little about the political economy of trade bargaining and related issues, I invite others to solve the problem of collective representation in a new executive body for the WTO.

Turning, instead, to the Bretton Woods institutions, let me lay out a proposal for reforming the governance of the IMF. A similar plan might be devised for the World Bank, although the Bank and Fund are differently designed to serve different purposes.

The Fund has a plenary body much like that of the WTO, but it uses weighted voting. Each country possesses a number of votes roughly proportional to its quota—the same quota that governs its financial contribution and its access to IMF credit. Many important decisions, moreover, require a 70 or 85% majority of the votes cast, which gives the United

States a *de jure* veto in respect of certain key decisions, because it has more than 15% of the votes.

Day-to-day decisions, however, are made by the Executive Board, which has 24 members. Eight are appointed by individual countries: the United States, Japan, Germany, France, the United Kingdom, Saudi Arabia, China, and Russia (see Table 3). Sixteen are elected by groups of countries and then cast those countries' votes. But some of those groups are represented by Executive Directors from EU and other industrial countries, which gives the industrial countries preponderant voice and voting power in the Executive Board.

These arrangements do not visibly affect much of the day-to-day work of the Executive Board, where many decisions are taken by consensus, but the voting power of the industrial countries also defines the basis for seeking consensus. There is no point in trying to achieve consensus on a course of action that will be opposed by the major industrial countries. Yet, experience surely suggests that the industrial countries are not all-wise. They were indeed chiefly responsible for serious errors made by the Fund in the recent past. I therefore propose a major reform of the Executive Board. The details of the plan outlined below matter less than the general thrust, but it is often easier to lay out a plan than to discuss it in general terms.

First, the EU countries should be consolidated into two constituencies—one for the 12 euro zone countries and one for the 13 other EU countries. As this would remove EU countries from some of the other constituencies, those constituencies should then be reconfigured, and that can be done along the lines suggested in Table 3, with the further effect of reducing the number of Executive Directors from 24 to 20.

Second, each Executive Director should be given *one* vote in the Executive Board on all matters other than those explicitly cited in the Fund's Articles of Agreement as requiring a 70 or 85% majority. Decisions by the Board, however, should require a 60% majority of the votes cast. In other words, no fewer than 12 Executive Directors must vote in favor of a proposal when all 20 are present and voting. This rule would deny the United States, the European Union, and Japan the *de facto* veto power they currently share in respect of most decisions involving a formal vote, although they could continue to expect support from some of the other Executive Directors.

Third, the consolidation of EU representation shown in Table 3 strongly suggests that the EU countries exercise disproportionate voting power in the IMF. The share of the euro zone countries, taken by itself, is a third larger than the share of the United States, and the case for reducing that share would become utterly obvious if the intra-trade of the euro zone countries were dropped from the trade data used to produce the numerical benchmarks for setting actual IMF quotas. And there is a persuasive analytical case for excluding that part of their trade. It is possible but pointless to calculate the balance of payments surplus or deficit of a single region within the United States. It is equally possible but equally pointless to calculate the surplus or deficit of a single country within the euro zone. The settlement system that links the national banking systems of the euro zone provides a deficit country with open-ended financing. It has no need whatsoever for access to IMF credit—which is, of course, one reason for having an IMF quota.

This three-part reform of the IMF will not find favor in the national capitals of the major industrial countries. But this sort of reform may be needed if the developing countries are to take ownership of the policies they must adopt to minimize the tensions that may otherwise arise from their growing role in the world economy.

Table 3
Reorganizing the IMF executive board

Country or country group*	Number of countries		Share of total votes		Notes
	Actual	Proposed	Actual	Proposed	
EU Euro zone	–	12	–	22.94	
United States	1	1	17.11	17.11	
EU other	–	13	–	8.97	
Japan	1	1	6.14	6.14	
Germany	1	–	6	–	Merged with EU Euro zone
France	1	–	4.95	–	Merged with EU Euro zone
United Kingdom	1	–	4.95	–	Merged with EU other
Saudi Arabia	1	1	3.23	3.23	
China	1	1	2.94	2.94	
Russia	1	1	2.75	2.75	
Belgium, Austria, Hungary and others	10	–	5.14	–	Redistributed
Netherlands, Ukraine, Romania and others	12	–	4.85	–	Redistributed
Italy, Portugal, Greece and others	7	–	4.19	–	Redistributed
Sweden, Norway, Denmark and others	8	–	3.51	–	Redistributed
Switzerland, Poland, Uzbekistan and others	8	–	2.85	–	Redistributed
Ukraine, Romania, Turkey and others	–	19	–	3.41	New country group
Australia, Korea, New Zealand and others	14	14	3.33	3.33	No change
Canada, Jamaica, Bahamas and others	12	11	3.71	3.31	Ireland moved to EU Euro zone
Indonesia, Malaysia, Thailand and others	12	12	3.18	3.18	No change
South Africa, Nigeria, Zambia and others	20	20	3.18	3.18	No change
Kuwait, Libya, Egypt and others	13	13	2.95	2.95	No change
Switzerland, Norway, Israel and others	–	5	–	2.91	New country group
Mexico, Venezuela, Guatemala and others	8	7	4.28	2.86	Spain moved to EU Euro zone
Brazil, Colombia, Trinidad and others	9	10	2.46	2.47	Timor-Leste added
Iran, Algeria, Pakistan and others	7	7	2.45	2.45	No change
India, Bangladesh, Sri Lanka and others	4	4	2.4	2.4	No change
Argentina, Chile, Peru and others	6	6	2	2	No change
DR Congo, Cote d'Ivoire, Cameroon and others	24	24	1.41	1.41	No change

Source: International Monetary Fund Annual Report 2003, Appendix VII.

* Country groups denoted by group name or by names of three countries with largest numbers of votes.

4. Conclusion

The Atlantic partnership has been and should continue to be the most influential actor on the international economic stage. It will lose influence, however, if it does not review and reform the arrangements it has designed to foster economic cooperation among the major industrial countries and does not pay greater attention to the needs and aspirations of other countries, especially those of large emerging-market countries. Agreement between the Atlantic partners is still required if cooperation is to be sustained and an open, integrated global economy is to be preserved. But agreement between the Atlantic partners will not be sufficient for that purpose in the years ahead, and institutional reforms are thus needed to sustain cooperation. Although the reforms proposed in this paper are rather modest, they will surely be opposed by governments and bureaucrats whose influence would be diminished by them. They should be adopted soon, however, to signal the willingness of the Atlantic partners to contemplate the further, far-reaching reforms that may be required in the years ahead.

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