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Where are we drifting apart?

A Re-examination of US-European Relations from an Economic Point of View.

I. The over-estimation of foreign-policy differences

If it is true that writers have a special sensibility for future developments or trends, I'd like to draw your attention to Paul Erdmann's new science fiction novel "The last Days of America". This bestseller analyses the process of the military, political and economic decline of the US in the eighties - leading to the result that Strauß wins the '84 election with a land-slide victory. The key plank in his platform is: the nuclear national rearmement of West Germany because the US are unable to continue guaranteeing West-European security vis-à-vis the USSR. I'd like to underline that this book is not a product of so-called European Anti-Americanism but written by a US-citizen.

But back to reality. The decline of political legitimacy and economic success is - at least - more true for the side of the Soviet Bloc than for the one of the Western Alliance. Only in military terms the Soviet Union remains very strong. It is subject of discussion within NATO how to react to this situation.

I don't think it's appropriate to over-stress this as a crisis of the Western Alliance. I'm absolutely sure that the fundamentals, based on common values and interests, as well as the simple assumption, that security could only be guaranteed in co-operation are still unchallenged and unshaken. But one has to take into account, that NATO is not only limited in its purpose and region, but that it is a league of fifteen - sorry, today only fourteen - democratic and sovereign nations. Each of them demand that its national interests are highly respected. This fact is an extremely important difference to the Warsaw-Pact - where the Eastern European countries mainly are forced to follow the line of the Soviet Union, no matter whether it fits into their national interests or not - with the result of an increasing Anti-Sovietism in these states. To put it into a nut-shell: the allies of the USSR are easy-going but unreliable, in NATO the allies are troublesome but reliable.

After this more general statement, I'd like to elaborate shortly on the security challenges we are facing and the different perception and strategies which are discussed in Europe and the US.

I think, most of us agree that the world today is more dangerous than - maybe - ten years ago:

- Afghanistan happened and Poland showed - not for the first time - how fragile the internal stability of Eastern Europe is;
- the Middle-East-Conflict has - despite the Camp David Agreement - become more uncalculable and is still jeopardizing the economic stability of the West, although the dependence from OPEC-oil declined;

- the instability of Third World Countries is increasing, generating a bulk of regional conflicts in which the super-powers one day might get involved. The North-South-Conflict as well could lead to rising international tensions.

I don't want to discuss neither the implications and reasons for the tough foreign-policy rhetorics the Reagan-administration uses mainly for domestic reasons nor the question, how European concerns are reflected in US-mass-media. Besides this - and much more important from my point of view - there are three points of different perceptions, leading to different conclusions.

1. The foreign policy of the US is concentrating on its adversary, the USSR, another nuclear world power. European concerns concentrate on all three kinds of international risks, I mentioned before, and Europeans don't believe that the other conflicts could disappear if the Soviet Union would change its behavior.
2. There are different opinions of the role which NATO has to play in the current situation. The US government demands NATO to play an active and global role (including, of course, a remarkable increase in military spending), whereas the Europeans stress more the limited purpose and area of a defense alliance against the Soviet threat in Europe.
3. The difference, how to react to the present Soviet behavior has been more significant. It's not a question of a moral judgement of what happened in Afghanistan and Poland. There is no doubt that all members of the Western Alliance totally condemn these events unanimously. But a common reaction to the challenge is missing. For

certain reasons:

- different historical experience, i.e. Europeans remember well, what happened after Berlin '53 and '61, Hungary '56, CSSR '68, the worker riots in Poland in '56, '70 and '77 (in '56 and '70 more people had been killed than in '81). Even at times of an absolute nuclear superiority of the US, the degree and possibility of influence to internal developments in the Eastern bloc proved to be extremely limited;
- different approaches about the effects and implications of trade and technological transfer. Already in the fifties we had a controversial discussion on whether hungry or well-fed communists are *less* aggressive - to put it down to earth terms. In the beginning of the '60s we took the decision for the latter option and, from my point of view, the arguments remain the same;
- and, last but not least, different benefits from detente policy, which are of course in Europe and especially West Germany much more visible and distinct than in the US. That is one of the reasons why Europeans will stick to detente policy as long as possible. The other is, that the alternative, to go back to the Cold War, seems not to be very promising as the past has shown.

There are these differences in opinions within the Alliance but they are not insurmountable. Both sides on the Atlantic are willing and prepared to finally come to a common approach. What we need is a review-process like the one of the Harmel Report in '67/68 which came up with recommendations for defense and detente policy within NATO - a policy we are pursuing until today. But within the last 15 years the

world has changed and there is, of course, the need for readjustment. I think, that our current policy-framework is flexible enough to cope with this readjustment process (and I don't think that a complete policy reversal is possible or necessary). However, I plead for a greater measure of levelheadedness. My interest in politics goes back to the year 1960, and since then I have under four US presidents seen situations in which relations between Europe and the United States were said to have "reached an all-time low". It would really be a bad joke of history if we were to allow others to talk us into believing that the inability of the Soviet system to meet the basic needs of its citizens and adapt its social structures to changed conditions is a crisis of the Western Alliance.

II. The persistent Economic Crisis - the real threat for the Western World

The real menace to a stable alliance seems to root more in the bleak economic outlook than in the political differences in opinions, mentioned above. And to a remarkable higher degree than in the political and military area, the US has failed to pursue a responsible economic policy adequate for an "economique dominante". Since the break-down of the post-war monetary system of Bretton Wood in '71 - an often forgotten but nevertheless lasting negative and grave consequence of the Vietnam-War - the US has been widely regarded as an economic "trouble-maker", not as a "trouble-shooter". This criticism has been brushed up as a result of the long-lasting and world-wide recession after the second oil-price crisis.

This perception is suitable to undermine the political leadership of the US to a higher degree than all sort of foreign policy quarrel, because it is affecting much more the average "man in the street". (in his real life)

I would like to elaborate shortly on three economic risks in the months to come which really could jeopardize the cooperation within the Western Alliance (and I strongly believe that a smooth political cooperation could only work on the basis of a close economic cooperation):

1. The "interest-rate-war"

The economic experiment of "Reaganomics" - the approach, to fight inflation by monetary means only and to stimulate at the same time the economy by fiscal means - has not only led to extreme high interest rates (partly caused by accelerating budget deficits) but has pushed the American economy to the brinkmanship of a deep and long-lasting recession, too. Of course, the Americans are hurt most by this policy, which, at least, is protracting the upswing of the US economy. But in addition there is a severe impact on the European economics, as well. Given the fact that the second oil-price-crisis has thrown the European countries into a current account deficit, they are now depending on high interest rates for attracting capital-imports in order to compensate their balance-of-payment deficit.

Only extreme strong economies, which could get rid of the current account deficit, (like Japan and - forthcoming - West Germany) could decouple more or less their domestic monetary policy from the dominating impact of the US monetary policy since their currency is appreciating and thus able to compensate interest-rate differences by appreciation-expectations. But what is the alternative to weaker European economies?

There is an increasing pressure noticeable to decouple from the impacts of US monetary policy by administrative measures (i.e. capital-flow-control, split currency markets). This is regarded as the ultimate mean to gain space for stimulating the domestic economy what is so urgently needed in view of accelerating unemployment figures. This development is undesirable and extremely risky; such an "interest-rate-war" might shake the fundamentals of economic cooperation and integration, so far reached in the Western Alliance.

However, one has to recognize that high interest rates are not the only economic problem of the Western industrialized countries. In the years to come, they will be involved in a difficult, costly and painful process of long-term adaptation: sky-rocketing energy prices (despite the current, but instable oil-glut); increased international competition with advanced developing countries; new technological advances; changes in demand, in lifestyle and in pattern of consumption; the conflicting goals of economy and ecology. These are but a few of the problems which are part of the economic adjustment process. But in this economic environment the strategically important, long-term-orientated investment in modernization and basic economic restructuring (i.e. in the energy sector) is especially hard hit by high interest rates.

2. The temptation of protectionism.

The combination of a sluggish economy and huge trade-balance deficits is leading to an increasing pressure for protectionist measures. Almost all Western industrialized countries try to "re-conquer the domestic market" by self-restrain-agreement, non-tariff-barriers and hidden import restrictions instead of improved competitiveness. The governments are more or less sinners - with an amount of creative fantasy which is missing

in tackling other problems. The demand for protectionism in Congress is obviously mounting despite the administration's resistance. Charges against "unfair trade", possible legislation for "reciprocity" and budget-amendments "to buy American only" (e.g. military equipment) are reasons for concern in the European capitals, in particular since the current US account is recently showing a deficit. Partly, this deficit is a result of the high-interest-rate policy: The tight monetary policy leads to an over-valued dollar, thus promoting imports and impeding exports. Partly, it is due to the administration's policy of "benign neglect": the non-intervention in the currency-market with the result that the value of the dollar so far has over- or undershot the range of the "real" value determined by economic fundamentals (that is the gravest mistake of a narrow-minded monetarist approach - to neglect the external value of a currency and to concentrate on the internal value).

3. The crushed debt burden.

Often failed to have been noticed, especially in the US, is the fact that the debt-financed industrialization has not only thwarted in Poland or Rumania. The strategy to import capital-goods, pre-financed by credits, and to have the debt paid back with products out of that equipment, failed in many Third-World and threshold-countries, looking at mere figures and ratios, like GNP to foreign debt or interest-obligation to export-earnings - there are countries worse than Poland. Most of the recycling of "petro-dollars" has been done by private institutions - under the basic assumption that a country couldn't be declared as default, as some short-sighted hard-liners proposed in the case of Poland. Maybe they really didn't know that this would lead

to a complete re-assessment of each debtor country - regardless of the political system - and each debt therefore would have triggered an "avalanche" in the financial market. Nobody had known where to end up, because so far the international monetary institutions or supportive action by the creditor-countries always bailed out the debtor through moratoriums, re-scheduling of the debt, lowering the interest rates a.s.o. (e.g. in the case of Chile (1973), Peru (1977) or Turkey (since 1978)).

The amount of debts, the gloomy export-prospects for most countries, the political and commercial risks involved ¹⁾ - all this impose a permanent threat to the smooth operating of all financial institutions, we depend so heavily on. No attempt to tackle this problem on an international level has been done so far.

III. Conclusion

The simple conclusion of my analyses is the following: We are able and prepared to overcome the differences in the field of foreign policy. However, the real challenge to the stability of the Western Alliance, maybe even to the survival of democratic welfare-states lies in the economic field. Until today we have avoided to lapse into a "beggar-my-neighbor-policy" - a big success compared to the first World-Economic-crisis in 1929/35.

1) For a detailed analysis see: Schäfer, M.B. (ed), Gefährdete Weltfinanzen, Bonn 1980 and the Annual Report of the International Monetary Fund 1981, Washington D.C.

But the lasting of this policy cannot be taken for granted, let alone the solution of new problems, which have arisen since the early seventies. In the cautious language of international organisations, the OECD stated in its last "Economic Outlook": "It is becoming increasingly evident that devising a truly satisfactory domestic economic policy necessarily also involves an important additional dimension of assessing its likely international interaction with the policies of other countries." The real problem - in contrary to the well-defined foreign-policy-problems - is a lack of consciousness and awareness of the economic risks, which might shake the Alliance in the months to come.