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The United States Needs German Economic Leadership

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On January 13, Germany's new chancellor, Angela Merkel, will have her first official visit with US President George W. Bush. Washington, or at least the part of Washington that still pays attention to transatlantic issues, not just the Bush administration, will be glad to see her given that she is not her US-bashing predecessor Gerhard Schroeder. Though this change in atmosphere is welcome, no one should make too much of it. It is unlikely to make much difference on security issues, where Iran's own actions are forcing the United States and Germany to come together, where German public opinion will keep the governments apart on Iraq, and where neither country is prepared to make major changes to defense budgets and approaches. The Masri case will certainly limit Merkel's interest in appearing too chummy with Bush on security matters.[1]

Where Chancellor Merkel will find several opportunities to take a new and constructive tack is on transatlantic economic relations. German-American foreign policy tensions over the Iraq war indeed have failed to spill over into the economic sphere, consistent with the pattern of most of the postwar period. Underneath this amity, however, remain several real and troubling economic challenges that only explicit intergovernmental action can resolve. The lack of policy actions to address these challenges in recent years, let alone of direct cooperation between the German and American governments to deal with them more fundamentally, has created a situation where the United States urgently needs Germany's help in the form of economic leadership.

All these issues concern Germany's role in guiding the European Union toward more liberal stances and greater economic engagement beyond EU borders. With the United Kingdom having squandered its six months in the rotating EU presidency, and in fact having alienated some of the more promarket newer member states of eastern Europe over the EU budget, the need for Germany to speak up on economics within Europe is more dire than ever. Its capability to do so has been enhanced with Merkel having resolved this year's EU budget crisis through her deft diplomacy upon taking office.

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Ironically, as Germany in recent years has emphasized its relationships *within* Europe, it has shown less *leadership of* Europe. This has disappointed and increasingly frustrated Washington, particularly American multilateralists. The United States has for decades counted on Germany to be the decisive swing vote between French and British views on economic and security issues and more broadly to encourage the European Union to look responsibly beyond the mutual protection of national interests.

While the United States cannot offer as much directly on the security front to Germany as it did during the Cold War, Germany's postwar economic leadership was always more in

1. Khalid el-Masri, a German national, was forcibly transported by the CIA from Macedonia to an Afghan prison by acknowledged mistake as part of the US "rendition" of terrorists. This became a cause célèbre in Germany and throughout western Europe and dominated press coverage of US Secretary of State Condoleezza Rice's meetings with Merkel in Berlin in December 2005.

its own self-interest than simply payback for the American security guarantee. In fact, as globalization proceeds and economic performance in the eurozone continues to stall, it is all the more important for Germany to keep the global economy open and stable.[2] Germany was once again the number one exporter in the world in 2005, and net exports have been the primary source of growth in the German economy in recent years.

At the same time, by showing leadership in these crucial economic issues, the new German government is likely to elicit more constructive behavior from US officials in areas where bullying or disregard of EU views has become increasingly the norm. If US officials see the economies of continental Europe in general, and Germany in particular, as declining and their international economic policies as fecklessly pursuing narrow state-sponsored advantages, then such disregard can become increasingly destabilizing for the global economy.

The key areas of German opportunity and US need are reducing agricultural subsidies, coordinating on relations with China, and securing the flow of international investment.

BUYING OUT AGRICULTURAL PROTECTION

Recent discussions have thankfully already made it trite to recognize that agricultural trade liberalization would do more than almost anything else to bring the developing world out of poverty (Cline 2004 and references therein). It has also become obvious that in the absence of such liberalization, the Doha round of multilateral trade negotiations will fail. The rich world's resistance to liberalization ultimately rests upon the ability of France and Poland to subsidize their farmers using the European Union's common agricultural policy (CAP) rather than buying them out. If Germany can get the French and Polish governments to do what it did to reduce its workforce of coal miners in decades past—and what South Korea is committed to doing to buy out its own farmers—then the dominoes will have little choice but to fall in Tokyo and Washington as well (particularly after the official statement made at the APEC Economic Leaders Meeting in November 2005, which put the ball in the European Union's court).[3]

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Only Germany has the bilateral economic relationships and the sizable EU net donor position to give it real influence over French and Polish policy, and every prior trade round has depended upon Germany to step up precisely this way. Past instances of such leadership relied upon German industrial exporters prevailing upon the German government to base its policies on the overall stake of the German economy in the trading system. But for the past few years Germany has gone in the opposite direction, with Schroeder caving in to French President Jacques Chirac's agricultural demands and leaving the United Kingdom out to dry on its EU budget proposals to link its rebate to CAP reform.

Merkel could save the Doha round by reinterpreting the budget deal just made on agricultural support funds at the EU summit. Germany can keep the agreed amount of money for the EU agriculture budget unchanged but use that money in different ways than export subsidies and other trade-distorting agricultural aid.[4] So doing would remove a transatlantic conflict (and threat of the United States legitimately scapegoating the European Union) while helping the poor countries. Merkel could even offset some of the drag on German consumption from her own proposed sales tax increase by getting German food cheaper, making it more worthwhile for her to go up against Germany's neighbors. This would be a good payoff for a return to traditional German leadership in EU trade policy and something the United States would be grateful for but cannot by itself achieve.

COORDINATING ON RELATIONS WITH CHINA

China's rise is more than just an economic issue, but Germany and most other EU countries treat it that way. In

2. Posen (2005a) argues for the self-interest of Germany, as well as the global interest, in Germany securing globalization by asserting leadership of the European Union on economic liberalization.

3. "We call for breaking the current impasse in agricultural negotiations, in particular in market access, which will unblock other key areas…," APEC Economic Leaders Statement on Doha Development Agenda Negotiations, 13th APEC Economic Leaders Meeting, Busan, South Korea, November 19, 2005.

4. A claim could be made that all the EU states just committed to not reopening the budget deal on agriculture until at least 2009. But, as with the Stability and Growth Pact, the EU Takeover Code, the EU Services Directive, and so on, all intergovernmental agreements within the European Union are subject to renegotiation in the guise of reinterpretation if the major states decide to do so. There is certainly no reason the French and Polish should get away with keeping the CAP deal more sacrosanct than all the other deals.

fact, Europe free rides on and occasionally tries to exploit American willingness to stand up to China—when political tensions rise across the Pacific, European premiers are eager to make a trip to Beijing to land Airbus contracts or sell their country's other products at the expense of American competitors. This reflects both a divergence in threat perceptions between the European Union and the United States and sheer opportunism. On both counts, it is a short-sighted strategy, and one likely to reinforce American beliefs that Europe cannot be trusted to take a responsible approach to security issues. Merkel cannot change this overnight with one initiative, and unilaterally holding back Germany's commercial opportunism would simply offer other EU countries even more room to swoop in for Chinese sales.

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What Merkel can do, in both Germany and America's interests, is pick specific issues where Germany can encourage coordination with the United States on relations with China in the G-7 and in Brussels. So doing would reduce conflicts between China and the United States by credibly closing off China's ability to play on western divisions in some areas and thus increasing the Chinese incentive to cooperate—it would also diminish the overall divergence in views on China between the United States and its European allies. In fact, Germany could in cooperation with the United Kingdom push for a reorganization of EU representation in both the formal international institutions (such as the UN Security Council) and the G-7/8, such that a new G-12 or G-20 could emerge, which would give voice to China and other major emerging markets. A cutback in the number of seats allotted to European nations would be necessary to keep the groups workable but would serve the ultimate German goal of strengthening the representation and role of Europe. In the face of such a consolidation, the United States would in its own interest have to give more recognition to the importance of a coherent European voice on the world stage.

A good place to start would be for Europe to join the United States in pushing for a Chinese currency revaluation. European leaders have publicly and privately suggested that the confrontational American approach to getting the Chinese government to revalue the yuan is mistaken. Merkel should take advantage of the American bad cop role to play good cop rather than just standing by. In particular, under German urging, the eurozone can offer to consolidate its constituencies and shares in the International Monetary Fund and the World Bank in return for a revaluation of the yuan and other Asian currencies.[5] The eurozone could shift several percent of its shares to China, Japan, and others, and still retain a large enough share both to exceed that of the United States and to retain effective veto; the United States could also cut its quota as part of making the redistribution of voting accurately reflect the changed world.

If the United States continues to face China alone on the currency issue, the Chinese government is unlikely to move the yuan peg meaningfully. In that case, any dollar declines will fall primarily on the euro to adjust, and protectionist sentiments in the United States will continue to rise—the United States and Germany have a common interest in avoiding this outcome.[6] On the other hand, if China does not respond to the eurozone offer, Germany and the European Union will have lost nothing but still added consolidating and strengthening eurozone representation to the international financial agenda and shown solidarity with the United States that can pay off later should the dollar move sharply against the euro.

STEMMING THE SPREAD OF RESISTANCE TO FOREIGN OWNERSHIP

One would think that after decades of the most backward developing countries demonstrating the economic costs of kicking or keeping out foreign direct investment (FDI), resistance to foreign ownership would be a dying issue. Instead, this sentiment is growing. Just recently, the US Congress de facto blocked a Chinese company (China National Offshore Oil Corporation [CNOOC]) from taking over strategically unimportant Unocal, and the German government threatened its largest bank not to consider international mergers in order to maintain a national champion in financial services. With Germany and the United States setting these examples, France, Italy, Japan, Russia, and a host of emerging markets have encouraged their own barriers to cross-border ownership and rejected recent bids from abroad for their companies.

5. See Posen (2005b) for a discussion of this proposal from the Asian perspective. Broader discussions of the virtues of consolidating eurozone representation in international financial organizations are provided in Henning (1997) and Truman (2005a).

6. Truman (2005b) gives an estimate of how much the euro would appreciate under various scenarios of Asian currency movement when the US current account adjusts.

Aging, high-savings Germany cannot afford to lose the investment opportunities that FDI outflows would yield, and the moribund German services sector can only gain from FDI inflows, which infuse knowledge from abroad. Both US and German multinationals would lose efficiency and returns to capital from a hostile environment toward foreign ownership and investment. By living up to the European Union's own stated rules for takeovers, and thus reversing her predecessor's blockage of their implementation, Merkel could help bring both the United States and Germany's neighbors to their senses. The tit-for-tat spiral of ad hoc decisions against foreign bidders could then be stopped before more noxious legislative barriers are erected around the world. All this would help protect the ties between economies, encouraging continued cross-border integration of production as well as flows of capital, regardless of what happens in the trade round.

Reducing agricultural subsidies, coordinating on relations with China, and securing the flow of international investment are the most pressing issues on the economic policy agenda.

In practical terms, the United States and Germany could reverse the effect of their recent actions to block cross-border mergers by simplifying the process in three ways: First, they could agree on a narrow definition of what constitutes a "national security" exception to the presumption that cross-border mergers should be allowed (subject to equally well-defined antitrust concerns).[7] Germany as both a leading member of the North Atlantic Treaty Organization (NATO) and a huge investor in the United States is well-positioned to convene a substantive intergovernmental working group on this. Second, the United States and Germany should bring accounting standards negotiations to a close, which would remove uncertainty for prospective investors. Despite the costly imposition of Sarbanes-Oxley legislation in the United States, there is still room for some common principles for public companies, and Germany represents one of the major alternative points of view to that of the United States. Third, President Bush and Chancellor Merkel should make statements, perhaps jointly with other western and Japanese leaders, publicly repudiating the often-invoked image of foreign investors as "vultures" who prey on domestic businesses and employees. Pointed speeches in this case would actually mean a great deal, given the populist anticapitalist rhetoric invoked by German officials in the spring of 2005 and the silent acceptance by President Bush of the congressional overreaction to the CNOOC bid in the summer of 2005.

AMERICA CANNOT DO IT ALONE

Resolving the current deadlocks over trade negotiations and currency adjustment and defusing the increasing momentum of economic nationalism with regard to cross-border investment are the most pressing issues on the economic policy agenda. They are also areas where substantive agreement in the German-American relationship is feasible on the basis of common interest and where such agreement would have significant positive impact on EU and thus global policy outcomes. Other areas where German leadership over the longer term could benefit the United States are in relations with Turkey, by putting more economic meat on the vague "privileged partnership" Chancellor Merkel has already offered that critical nation, and in public investment in the development of future energy technologies (e.g., carbon emission sparing), where Germany has technical capabilities and huge popular support for progress (and will waste money on industrial policy in any event, so better for a good purpose). Germany reaching out in these ways will also directly benefit the German economy and the course of European integration.

Neither President Bush nor Chancellor Merkel should take transatlantic economic relations for granted just because they will get along better than he and her predecessor did. So doing would risk mounting conflicts for Germany (and the European Union) with the United States over relations with China, investment, and trade. So doing would also squander opportunities for Germany to simultaneously improve its own and the European economic outlook and to reestablish clearly the benefits to the United States of sharing leadership in global affairs with Germany and Europe. In fact, German-American cooperation could be the basis for saving the Doha trade round. Reducing agricultural subsidies, coordinating on relations with China, and securing the flow of international investment are also issues where there simply is no American substitute for German initiatives on the international economic agenda—and the Bush administration certainly should, and probably would, welcome the progress that German leadership could bring.

7. Graham and Marchick (forthcoming) discuss in more detail the reasons to limit narrow considerations of national security exceptions in the US investment approval process.

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