Analysis

Transatlantic relations in dire financial straits

Josef Braml

Weak economic growth, high unemployment, an enormous budget deficit, and the Sword of Damocles of the credit agencies that threaten to further lower the credit rating of the country: the United States in President Obama's second term remains focused on itself. The economic imbalance as well as the domestic conflict between White House and Congress has brought the world power to the edge of its political ability. In foreign policy, too, the global hegemon can no longer deliver such global public goods as security, free trade, and a stable lead currency but, rather, needs to try harder to shift the burden of global responsibility over to its competitors and allies, be it in connection with the targeted softening of American currency, protectionism in trade policy, or burden-sharing in security.

Heavy debt inheritance

Barack Obama took over a difficult legacy: a miserable economic situation and empty reserves. The guns-and-butter policy of George W. Bush, tax reduction in spite of immense defense outlays, has had a strong effect on the budget. Along with that came, under Obama's leadership, billion-dollar recovery and development programs, to cope with the greatest economic and financial crisis since the 1930s.

A record deficit of 459 billion dollars was reached in fiscal year 2008. In 2009 the shortfall was three times as high: 1,413 billion dollars. In the two following years the budget was again overdrawn by around 1,300 billion dollars respectively. And again in the following fiscal year that ended on September 30, 2012, the Congressional Budget Office estimated the budget deficit to be over 1,100 billion dollars.

Because the multi-billion-dollar deficits grow year by year, Congress had to raise the government debt ceiling in February 2010 and to extend that measure in 2011. In summer 2011, with the heavy conflict around raising the ceiling, it became clear that the political system was blocked. That such an action, which in the past would have been routinely settled, has now led to intense political strife points to the serious nature of the situation. Even the threats of the credit rating agencies to lower the credit rating of the U.S. failed to bring the antagonists to reason. Thus in August 2011 Standard and Poor's (S&P) carried through on its warnings and lowered the credit rating of the USA from AAA to AA+.

After months of unsuccessful tugs of war that kept the financial markets in constant unrest, President Obama in the beginning of August 2011 finally signed the Budget Control Act. As the name of the law suggests, lifting the debt ceiling is tied to budget cuts: in the next ten years, some 2,400 billion dollars will be saved. A bipartisan

committee of representatives and senators failed to submit concrete proposals to save 1,500 billion dollars by the agreed upon deadline of November 23, 2011. As a result, since March 2013 an automatic mechanism has come into play, spread over most of the parts of the budget, in both social and military areas, to shave a portion of the entire budget on a purely percentage basis across the board (sequestration).

Blocked economic and trade policy

Even if the combatants are able to come together on a minimal compromise to avoid derailing the weakened economy through massive budget cuts, President Obama's initiatives to crank up the economy in his second term again face shipwreck in Congress. Ideological opposition, the influence of interest groups, and a political system prone to paralysis limit the maneuvering room for negotiation of policy – and particularly that of the President – and considerably encumber the plans to flip the necessary switches for the future. In the present power constellation the President and Congress are scarcely in a position to solve even the most acute problems. Should the President try to spur on the economy through deficit financing, he runs up against Congress, for the libertarians there, representatives of the Republican Tea Party movement, block any actions that would increase the deficit and are supported in this by the fiscally conservative Democrats, the Blue Dogs.

The Executive as a result has to look to achieve economic growth by promoting an increase in exports. In March 2010 the President proclaimed the National Export Initiative by executive order (that is, without the cooperation of Congress). The initiative aims to double American exports within the next five years. The Administration cannot count on the support of Congress. It was only in October of 2011 that Congress finally approved three bilateral free trade agreements (with South Korea, Colombia, and Panama) that Bush had wanted to push through quickly on the fast track years earlier.

Unlike his predecessor, Obama has not yet asked Congress to grant him the so-called Trade Promotion Authority. The TPA, whereby Congress allows the President to accept or reject trade agreements as a whole (that is, without amendments), ended in July of 2007 in the second term of George W. Bush's tenure. On the world stage, the President is taken seriously as a trade negotiator only when he has this authority. This situation has affected the negotiating power of the President with the member states of the World Trade Organization in the framework of the Doha Round where agreements have to be politically achieved without "ifs and buts". Similarly, without this trade authority it is impossible to think of a broad free trade initiative like the Transpacific Partnership (TPP) – to say nothing of the European/German initiatives for a Transatlantic Trade and Investment Partnership (TTIP), which is even less popular in Washington.

The Federal Reserve's game

In light of the blockage of the political forces in economic and trade policy, more attention has to be paid to the power of the Federal Reserve Bank to shape the U.S.

economy. To free the U.S. from its debt trap, the central bank buys up its own government bonds that no longer are prized by foreign investors. Or, it saves the financial sector from further meltdown, by relieving the banks of their real estate debts. Thus the Federal Reserve tries to keep the economy alive with spurts of liquidity.

As the Federal Reserve prints more money – the euphemistic trade jargon is "quantitative easing" – the American dollar is put under further pressure. But a softer dollar also offers the USA advantages: it not only limits the burden of debt financed from overseas, but it also helps Obama to further his ambitious export strategy. In the short term, the expansive monetary policy and the accompanying depreciated dollar should further the American export chances. Nevertheless, the longstanding structural problems of the U.S. economy that with the economic and financial crises have become obvious remain. Finally, the USA, with its slack monetary policy risks not only inflation and turmoil on international financial markets but also undermines trust in its own currency.

As long as state and institutional bodies continue to hold American government bonds in their portfolios or indeed increase their holdings so as not to endanger the value of their investments, as long as they remain in the "dollar trap" and the alternatives – investment in other currencies and countries – appear even riskier, then the dollar and American government bonds will be seen not as safe havens but as lifelines at a time in which the financial world appears to have lost its bearings. In this way the USA continues to profit from its "exorbitant privilege," as the then French finance minister Valery Giscard d'Estaing put it in the 1960s. With the dollar as lead currency the USA, unlike other states, does not need to pay a risk penalty in the form of higher interest rates but, rather, can borrow enormous amounts of money under favorable conditions and thereby attain much higher profits and – what is becoming increasingly clear in recent years – finance its consumption on credit. Not least, many developing countries, with their currency reserves, help the USA to live beyond its means.

Loss of power: weakening of the dollar privilege

America's most important foreign creditors, China and Japan, are greatly worried and are trying gradually to escape from the "dollar trap". China already has shown the limits of its tolerance and probably of its capacity to make its currency reserves available to the U.S. at no cost. Beijing will in the future try harder to invest in other countries and currencies. Europe offers good opportunities.

Further transatlantic tension is inevitable. The USA itself is no longer in a position to stimulate its economy through government spending. Thus it puts pressure on the Europeans to stir themselves to create global demand, which in turn is to be financed with new debt. On the contrary, the Europeans, especially Germany, are trying to get their economic problems in hand by reducing their debt. Moreover, they want to maintain their national political authority and also save European integration. These

fundamentally differing views affect not only the bilateral relations between the U.S. and Germany but also change the constellation of power on multilateral levels.

Already at the G-20 summit in South Korea in November 2010 it became apparent that the U.S. could forfeit its international leadership role. The U.S. failed in its proposal to define the limits of the balance of trade surplus for export-rich countries such as Germany and China. In addition, the American government representatives had to listen to much criticism of their economic and monetary policies from the community of states present. America, at the summit of the world's twenty largest economies, was thoroughly and unsparingly confronted with the facts that its role as world leader was no longer desired and that the power of the USA was noticeably damaged by the chronic weakness of its economy.

Thus the theme of the dollar as international lead currency is on the agenda of the G-20. During his term as G-20 president in 2011, French president Nicolas Sarkozy declared the international monetary system to be a long-term core topic for the group. For France, it concerns above all reduction of exchange-rate fluctuations and building up the Special Drawing Rights (SDRs) of the International Monetary Fund (IMF) to a supranational reserve currency to replace the dollar as lead currency. Toward that goal, a working group was established to test whether other currencies, including the Chinese renminbi, could be brought into SDRs currency basket.

Because the U.S. will continue to block a multilateral path regarding the SDRs of the IMF in order to retain the "dollar privilege", the other leading members must seek new ways, step by step, to remove themselves from dependency. From now on China will try to regionalize its own currency and, carefully, try to internationalize it. Already Beijing is trying, through trade and investment, as well as currency swaps with its neighbors, to establish the renminbi as the key currency in the region. To circumvent the dollar, it has, among other things, already concluded two agreements with Japan and South Korea for mutual recognition of currencies. China is working to establish a multipolar economic order with multiple leading currencies.

Sooner or later the currency markets will reflect the balance of power in international trade, namely, a multipolar ordering of the main forces: the dollar, in the foreseeable future, will have to share its leading function with the Euro and the renminbi. Consequently, the U.S. will in the future no longer be able, as up until now, to obtain the bulk of the currency reserves of other countries for free and to function economically through credit financing.

New positioning of security policy

The economic situation will also affect the defense budget, which represents the lion's share of the American budget overall. Yet for the foreseeable future, military might, the so-called "hard power" of the U.S., will remain uncontested because no other country in the world comes close to possessing so much attack force as the superpower. To

consolidate the budget, however, will require considerable cuts in the military area. This will further weaken the American economy, which is to a considerable extent dependent on this sector.

The economic woes of the USA have repercussions for security cooperation. Up until now Washington has maintained the costly strategy of a massive military presence in order to secure its energy resources and trade routes. But this strategy no longer can be maintained in light of the poor socio-economic position of the U.S. and the declining domestic support. America will try to pass more of the burdens of its peace keeping operations to its allies.

To reduce costs, the use of un-manned aircraft, so called drones, has grown enormously, for protection, support, and strikes against enemy targets, as well as for espionage and reconnaissance. As drones are being employed for strikes and reconnaissance, the classic air force is losing its mission and in this area, as well as in that of conventional troops, investment is dramatically declining.

President Obama has intensified missile strikes by drones in the border area between Afghanistan and Pakistan and has spread their use in Yemen and Somalia, with partial success, for drones have killed targeted important leaders of Al Qaeda. The U.S. risks, however, alienating the people of these countries, making recruitment by terrorist groups easier and causing diplomatic collateral damage. In the end, by using cheaper drones for U.S. domestic reasons, the U.S. may alienate allies, with whom it wants to share the burden of global responsibility.

Continental drift: less of Europe, more of Asia

The foreign and security policy of the USA will continue to concentrate on regions where vital security interests, especially energy interests, are involved – in the Middle East, Africa, and Asia. Even if the U.S. manages, through politically driven massive savings and development of its own resources, to markedly reduce the percentage of imported oil (and that is the Achilles' heel of the economy and transport sector in the USA), one has to consider a second aspect: the price of oil is internationally influenced by an oligopoly, called OPEC, as well as by unrest, supply shortfalls, and growth of demand in other regions of the world. For the foreseeable future, Saudi Arabia remains the only so-called swing producer, which has extensive capacities so that it can provide favorably priced oil quickly and in large quantity when demand is high, and in that way push down prices to a considerable extent, sustainable for Western and Asian economies, as it has done for some time. Saudi Arabia is the only oil supplier whose capacities are so high that it is able without a long preparatory period to provide two million additional barrels a day, reacting to tight supplies in other countries or suddenly rising demand. So the Gulf monarchy can defend the U.S. against other less-well-meaning states. In return, the world power USA protects Saudi Arabia militarily. Security for oil, the deal is called. In spite of the supposed energy self-sufficiency of the U.S., the Near and Middle East will remain, after Asia, of central importance for the U.S.

This is true not least because China pursues its energy and economic interests in the region through relations with Iran and Saudi Arabia. And China is, for the American strategy, at least as great a threat. Meanwhile, the OPEC states are no longer re-investing the petrodollars from the U.S. and Asian countries in the "land of unlimited opportunity" but, rather, in China. That is all the more problematic because the leadership in Beijing, the chief financer of the swelling American government debt, little by little is freeing its monetary reserves from the "dollar trap" and diversifying through investments in other places.

Nevertheless, the U.S. and China remain, in their economic and trade policies, dependent on one another. A weak turn for one will undeniably cause massive problems for the other. Experts who take a serious broader look at security policy hope that an understanding of this interdependence could help to temper the growing military rivalry between Washington and Beijing.

However, those who see only the constant and massively increasing military endeavors and the martial actions of China in the Pacific must fear that there is a hardliner in the Middle Kingdom that in the future will adopt an even stronger tone. In Washington, too, interested circles may no longer want to continue the increasing cuts in military spending, citing "the yellow peril". There also exists the danger on both sides that threat warnings motivated by particular interests could in turn become self-fulfilling prophecies.

American security policy is now centered in the Pacific, in order to maintain a counterweight to the strengthening China. To reinforce the U.S. in the Pacific President Obama, during his 2009 Asian trip, took part in the summit meeting of the Asian Pacific Economic Cooperation (APEC), where he also had the opportunity to meet with the ten heads of state and government of the Association of Southeast Asian Nations (ASEAN). Along with the future of the APEC agenda, dominated by Washington, intensification of the relations between the USA and ASEAN was discussed.

For America the ASEAN integration is of the highest importance. By 2015 there will be created a common free trade zone and a security, economic, and socio-cultural community will be established. Since Obama's entry into office the U.S. has undertaken increased diplomatic efforts to finally, on July 22, 2009 with Secretary of State Clinton's signing, become party to the Treaty of Amity and Cooperation (TAC), one of the chief documents of ASEAN. There the cornerstone for American's entering into the East Asia Summit (EAS) was laid: President Obama became the first American president to take part in the summit in November 2011. The ASEAN members welcome the engagement of the U.S. in the region because America's interest also widens their room for action, not least in relation to China.

Global NATO toward burden-sharing

After the testing problems of the Cold War and the fight against terror, NATO, too, is coming up against new dangers that can come at us from "rising powers," as Leon Panetta announced in Brussels in October 2011, during his first visit as U.S. Defense Secretary. Looking toward the NATO summit in Chicago in May 2012 the allies "should look for innovative ways to enhance and expand our partnership both with those countries outside NATO that are exceptionally capable, militarily, and those that strive to be more capable."[1]

A so-called Security Provider Forum had already been suggested by George W. Bush's administration in order to institutionally bind allied states that do not belong to NATO but are willing and able to substantially participate in certain missions. The theme "Broadening of the Alliance of Democracies" was initially brought on the agenda in 2004 by then American ambassador to NATO Nicholas Burns, and it incited considerable controversy and increased transatlantic tensions.

Yet the theme is once again current, and will be pushed into the foreground by the budget constraints of the U.S. and its allies. Already at the summit meeting in Lisbon in November 2010 "strategic partnerships" appeared as the most important point on the agenda for the U.S., because it was future-oriented. While, as usual, the traditional obligation to collectively defend allied territory was reiterated, there also arose, forced by the U.S., alongside NATO's partnership policy, an orientation outward, particularly in the alliance's new strategic concept.

In April 2011 the foreign ministers of NATO tied up the Berlin Partnership Package, three ground-laying documents aimed at further development of the partnership policy and the "cooperative security" of NATO. According to the proposals of the leading power of the alliance and those of NATO Secretary General Anders Fogh Rasmussen, the NATO partnerships must in the future be made more flexible, more pragmatic, and more efficient. NATO should become "the hub of a global network of security partners", which will make room for more cooperation in military interventions and more dialogue in the decision-making process.

Should the Europeans not be ready or able to shoulder their assigned burdens, they have fewer valid arguments against the globalization of NATO. Whether the Europeans manage to give meaning to phrases like "pooling and sharing" and "smart defense" will have repercussions for the alliance. But even without the instrument of NATO, the U.S. will find new ways and means to bring Asian democracies alongside the transatlantic allies more strongly into fulfilling these duties.

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1. Leon Panetta, "From Tripoli to Chicago. Charting NATO's Future on the Way to the 2012 Summit," Transcript of a speech delivered in Brussels on May 10, 2011. Available on the website of Carnegie Europe under http://carnegieendowment.org.