

The G-2: A New Conceptual Basis and Operating Modality for Transatlantic Economic Relations

C. Fred Bergsten, Caio Koch-Weser

This paper was prepared by Dr. C. Fred Bergsten, director of the Institute for International Economics, and Dr. Caio Koch-Weser, deputy minister of finance of Germany, in their roles as co-chairmen of the Transatlantic Strategy Group on Economics, Finance, and Trade created and managed by the Bertelsmann Foundation during 2002-03. This group was part of a broader Bertelsmann project titled "The Future of Transatlantic Relations," conclusions and papers of which have been published in *From Alliance to Coalitions—The Future of Transatlantic Relations*, edited by Werner Weidenfeld, Caio Koch-Weser, C. Fred Bergsten, Walther Stützle, and John Hamre (Bertelsmann Foundation, 2004).

The G-2: A New Conceptual Basis and Operating Modality for Transatlantic Economic Relations

C. Fred Bergsten, Caio Koch-Weser¹

This paper proposes the creation of a new “G-2” consultative mechanism through which the European Union and the United States would manage their own economic (and possibly some security) relations and informally steer the world economy. It would address a growing number of issues through different groups of officials from different ministries on both sides of the Atlantic, perhaps loosely coordinated by an “overview group.”

The paper begins with a brief enunciation of the rationale for the G-2 and then addresses the key practical questions that would be involved in setting it up and operating it: What topics would it address? Who would address them?

It is essential to stress at the outset that the G-2, in playing its global management role, would be an informal process that would not replace any of the existing institutional mechanisms (including, for example, the G-7/8). To the contrary, it would seek to energize those broader groups, and greatly enhance their effectiveness, by providing leadership within them from the only two entities, the European Union and the United States, that together can make them exercise their own responsibilities more successfully.

It would do so through a constantly iterative process, in which the European Union and the United States would consult actively

1 The following article represents the personal views of the author and not necessarily the position of the German government.

with other relevant countries in each issue-area to make sure their views were taken fully into account in the G-2's own decision-making.

Conceptually, the new G-2 would represent the innermost of a series of concentric decision-making circles. The next circle, moving outward from the G-2 itself, would be the present "inner circles" such as the "finance G-7" (of finance ministers and, sometimes, central bank governors) on macroeconomic and monetary matters and the "quad" on trade issues.

Beyond these groups lies the next ring, the "executive committees" of the formal global institutions including the International Monetary and Finance Committee (formerly the Interim Committee) of the International Monetary Fund and (sometimes) the CG-18 of the GATT/WTO, which are intended to streamline and improve the functioning of those nearly universal organizations.

The multilateral organizations themselves, such as the IMF and WTO, constitute the outermost of the concentric circles that make (or ratify) the final and formal decisions in their issue-areas. Again, iterative consultations across the different circles would be a constant part of the process.

The need for a G-2

There are four basic reasons to create an informal G-2.

First, Europe and the United States currently have no conceptual foundation on which to base their relationship. The Cold War provided such a foundation for four decades but no replacement has yet been found. Absent such an intellectual basis, there will be constant risk of erosion or even rupture of transatlantic ties. The conflicts between the United States and parts of Europe during 2003 over Iraq and related issues of course heighten this concern.

Second, a G-2 would help counter the chief foreign policy shortcomings of each transatlantic partner: America's tendency to

unilateralism and Europe's tendency to insularity. Precisely because of its unquestioned superiority at this point in time, the United States needs a trusted and reliable ally to protect it from the constant go-it-alone temptations of superpower hegemony.

At the same time, given the present stage of its institutional evolution, the European Union needs a globally oriented partner to overcome the powerful impetus to self-centered behavior that derives from its enormous internal agenda. The events of 2003 also highlight these tensions.

Third, the world economy, like any political or social entity facing collective action problems, requires leadership from those of its members that have both the capacity and the will to provide it. This need is even greater now than in the past due to the rapid growth in the total number of state actors (187 members of IMF, 144 of WTO), and even more so in the growth of the number that have a real impact on the world economy (probably 30–40).

For the foreseeable future, only the United States and the European Union are economic superpowers that enjoy the capacity to steer the global economic scene. With the expansion of the European Union, the population, economic output (especially at PPP exchange rates), per capita income, trade flows, openness ratios and most other economic indicators of the two are remarkably similar.

Japan, once a member of a putative G-3, is fading and will probably continue to do so if only for demographic reasons. China is the rising power, and may need to be added to the leadership core in a few years, but is still a very poor country with an inconvertible currency, only halfway to being a market economy, and probably even further away from political democracy. Hence only the G-2 can steer the world economy for the foreseeable future.

Fourth, a G-2 already exists in at least a few issue-areas, demonstrating that the idea is feasible. It has been in place on trade policy for about forty years, since the original European Economic Community centralized that function in the Commission, and has

reached its zenith with the close current relationship between USTR Robert Zoellick and EU Trade Commissioner Pascal Lamy.

Their relationship indeed offers a unique opportunity to institutionalize the relationship that should be seized, as highlighted by the failure of even their unique partnership to prevent the breakdown of the WTO Ministerial Meeting in Cancún in September 2003. A G-2 exists in a sense in the military dimension through NATO, especially with the recent expansion of its initiatives outside the European theater. A G-2 is clearly a practical possibility.

What would a G-2 do?

This preliminary discussion suggests that a functional G-2 would always be simultaneously pursuing two sets of objectives: a more effective relationship between Europe and the United States themselves, and a more effective global economic order.

The basic idea behind the G-2 is to create a mechanism that would strive constantly to achieve these two objectives, which are almost always compatible and indeed mutually reinforcing. Indeed, harmonious transatlantic relations are a necessary condition for global stability and the latter is in turn extremely valuable, in both economic and political terms, to the European Union and the United States.

There are two basic strategies for creating a G-2. One would be “top down,” with a decision at the highest levels to develop intensive transatlantic consultation across a wide range of issues with ex ante determination of specific topics to pursue under that rubric (and probably under the direction of an overall steering committee that would relate the separate issues to each other and provide overall political impetus).

The alternative is a “bottom up” and more evolutionary approach, with opportunistic development of consultative ties on individual issues as there develop felt needs to construct them,

e.g., in the international monetary arena if sharp new instabilities in the dollar-euro exchange rate were to require more active cooperation on it or on environmental issues if the United States agreed to work seriously with the European Union on an acceptable successor to the Kyoto Protocol.

Whichever of these paths were eventually chosen, or permitted to evolve, it is useful to consider which issue-areas might be amenable to G-2 management. At least ten possibilities come readily to mind: trade, competition policy, regulatory policy including corporate governance, macroeconomic policy, international monetary policy, international financial markets, energy, the environment, migration and global poverty.

The experience of APEC, incidentally, which initially set out to be a sort of transpacific G-2 (though without a cohesive Asian pillar), suggests that officials in almost every issue-area will seek to organize their own consultative ties once a critical mass of other issue areas is reached—and especially if there is a “top down” decision from the highest political levels to pursue the concept, as there clearly was in APEC with its initial summits at Seattle in 1993 and at Bogor in 1994.

Trade, as noted, already enjoys a high degree of G-2 management. Even here, however, there are key systemic issues that are not being addressed such as each G-2 member’s rapidly proliferating network of bilateral trade agreements (where the “policy instrument” could be a strengthened Article 24 in the WTO) and the need for a more coordinated response to the critics of globalization. Moreover, this particular G-2 manifestation failed to prevent the WTO breakdown at Cancún.

There are two main issues: getting the G-2 to think of themselves primarily as stewards of the global trading system, rather than as mercantilist adversaries, and institutionalizing the strong personal ties that fortunately now exist in this domain (and clearly have been important in avoiding real trade conflict during this period of extensive and intensifying disputes).

Competition policy is another potentially fruitful area for G-2 management. If not quite as extensively as trade, it already enjoys a large measure of agreed European leadership at the European level and hence provides a clear partner for the United States. Consultation is already extensive across the Atlantic.

The GE-Honeywell dispute and possible future disagreements over Microsoft, however, highlight the substantive importance of forging much closer transatlantic agreement on both the philosophy and the procedures of antitrust prosecution. The rapid proliferation of new competition policies in numerous emerging market economies cries out for international leadership to minimize differences in both substance and process that can otherwise cause endless turmoil in future decades.

It should not be forgotten that this issue area became the focal point of much "trade conflict" between the United States and Japan for most of the 1990s.

One "policy instrument" could be publication of an agreed, and even joint, procedure for addressing antitrust cases that would avoid both duplication and risk of inconsistent results. Another, as already proposed by the European Union, would be addition of this issue to the agenda of the Doha Round in an effort to start forging an agreed international template for dealing with it.

Competition policy is of course only one aspect of regulatory policy, whose many dimensions could also benefit enormously from systematic G-2 management. The Transatlantic Business Dialogue (TABD) has in fact pursued a number of such issues, seeking Mutual Recognition Agreements (MRAs) à la EU itself in some. Even these seemingly technical discussions have often broken down, however, as when the Food and Drug administration of the United States refused to accept European certifications.

Macroeconomic policy is at once the most discussed and least operational of all the issue-areas on this list. The G-2 account for almost half the world economy have overarching responsibility

for its success, and their respective performances have surprisingly large effects on each other as well.

Yet there is little meaningful consultation, let alone coordination, between them despite the pressure of numerous discussion fora and evidence from earlier periods (especially the late 1970s) that such coordination can be quite effective.

To be sure, macroeconomic issues pose extremely difficult institutional issues (to which we return below), especially the independent role of central banks with regard to monetary policy and the famous “who speaks for Europe?” question on fiscal policy.

Nevertheless, concerted actions would seem to be particularly efficacious when the G-2 (and hence the world) face common macroeconomic problems, such as synchronized booms and slowdowns, the inflation of the 1970s and possibly deflation in the future.

There are of course numerous policy instruments that can be deployed, from simple coordination of public statements to help build market confidence to coordination of actual policy steps to enhance their effectiveness (including, in some cases, by avoiding contradictions and/or quantitative excesses from them).

International monetary relations, along with macroeconomic policy and by contrast with trade, are among the least active areas of G-2 management relative to the need. The dollar and the euro are the world’s leading currencies and the relationship between them has a major impact on the world economy.

The authorities in both areas are content to let market forces determine their exchange rate most of the time, however, despite the overshooting and misalignment that demonstrably prevail for prolonged periods and the resultant buildup of unsustainable imbalances such as the current U.S. foreign deficit (in excess of \$500 billion, or five percent of U.S. GDP).

In addition, there has been only limited reform of the “international financial architecture” since the crises of the 1990s. The system’s crisis prevention and crisis resolution mechanisms, especially with respect to major emerging markets, remain very weak.

Only intensified EU-U.S. cooperation and leadership can build the necessary defense mechanisms.

A closely related issue-area is international financial markets, where Europe is striving to complete its own integration (and thus bring the euro to equivalency with the dollar) and where a host of regulatory issues (e.g., Basel II) are at play.

Some of these issues of course relate directly to the corporate governance questions that are at the top of the contemporary agenda. This raises the prospect of joint policy instruments like the adoption of international accounting standards and common rules on key items such as expensing of stock options.

Energy policy is a critical issue where Europe and the United States have essentially “agreed to disagree” for some time. Philosophies, policies and practices (at both corporate and personal levels) are dramatically different on the two sides of the Atlantic and there are no serious efforts to reconcile them.

American military might and strategic petroleum stockpiles have sufficed to avoid major transatlantic problems vis-à-vis the oil markets in recent years, but the sharp conflict that flared after the first oil shock, and could have easily recurred in the context of the war in Iraq, should not be forgotten.

Possible policy avenues include serious joint efforts to accelerate the commercialization of low-carbon technology (e.g., in automobiles) and to commercialize non-carbon energy sources.

Closely related is environmental policy. Here too there are fundamental differences of views, at all levels, across the Atlantic as manifest most dramatically in the opposite positions on the Kyoto Protocol. One of the highest priorities of a new G-2 might in fact be to take a fresh look at global warming and to seek new approaches to address it effectively (including partly through new energy policies).

Both the energy and environmental issues of course have major implications for overall economic policy and performance, as well as important security inter-relationships.

Migration is another critically important issue for both Europe and the United States, especially when related to the aging of both populations (especially in Europe), but is perhaps discussed even less than the other topics on this list.

It carries huge social, economic and political implications for the sending as well as the receiving states, and hence requires effective global as well as bilateral management. It is unclear whether common action is needed in this area although, at a minimum, sharing of experiences and ex ante discussion of possible national policy responses would be extremely useful.

A possible new “policy instrument” would be to add of this issue to the Doha Development Agenda, which would clearly please the developing countries and provide potential breakthrough linkages between migration, trade and development policies.

A final possibility is global poverty. Particularly in light of September 11, security as well as humanitarian concerns suggest an emphasis on this topic. Africa could be an obvious focus as at recent G-8 summits. The specific topics involved cut across a wide range of economic issues: trade, private investment, foreign assistance, migration (see above) and numerous others.

The European Union and the United States have recently pledged substantial increases in both their foreign assistance levels and access to their markets for the exports of the poor countries. However, their aid levels are still far below the international norm (0.7 percent of GDP) and they persistently adopt new policies that retard rather than enhance market access (e.g., the recent U.S. steel safeguards and farm bill).

Concerted and bold new action by the G-2 is essential if the poorest countries are to be given a genuine opportunity to emerge from poverty.

In sum, all of these topics would almost certainly benefit from more systemic and more sustained attention by the responsible authorities of the European Union and the United States, working together within a new G-2 framework.

How would a G-2 work?

This list of specific candidate topics for G-2 management reveals immediately that any such process, if carried out on anything like the suggested scale, would engage very large numbers of people from a wide array of official (and perhaps private) institutions on both sides of the Atlantic. There would have to be a great deal of flexibility and informality in the process if it were to avoid becoming hopelessly bureaucratized.

The process could be viewed as deepening and institutionalizing, at the G-2 level, the transnational coalitions that already function in some areas (such as central banks, competition authorities, and trade officials) and creating new coalitions where they are either non-existent or very embryonic (as with energy and environmental officials).

Each responsible group could set out its own agenda and timetable, building on whatever practices were already in place. The mandate would be to establish, if necessary, and maintain a process of comprehensive consultation on the key issues being faced in each issue-area.

Three types of exchanges should take place in each group. One would simply be informational: full briefings on the latest developments in each region in the respective issue-areas, so that future actions in the other could at least take account of the partner's decisions.

The second could be on policy interactions, or the international implications of pending policies in one of the respective partners. The third and most advanced would be the possibility of occasional cooperative or even coordinated action to improve the prospects for effective response to a particular policy challenge.

The agencies and individuals that would be mandated to conduct these exchanges would of course differ from issue to issue. In the United States, the choices are relatively simple although

complications arise even here: two competition authorities and environmental policy authorities, four bank regulators, blurry decision-making lines for macroeconomic policy and a Congress that has ultimate authority over taxes, spending, trade and much else. It is not always clear “who to call” in Washington either!

Europe of course raises the added complication of the relationship between the member states and the institutions of the European Union as a whole, and sometimes among those institutions themselves, e.g., Commission vs. Council vs. Parliament. These are relatively clear for trade and competition policy, where the Commission largely “speaks for Europe.”

On most of the other issues, however, the EU is in the midst of a prolonged process of developing decision-making procedures that should ultimately provide a much clearer representative for G-2 (and other international) discussions.

A final operational element is the possible creation of a coordinating committee to maintain linkages and promote consistency between the issue-specific consultative groups. Such a committee is not essential but, operating as a small and very informal secretariat, could help keep the various pieces of the program in sync and avoid overlaps or inconsistencies.

The committee could also “assign” topics to individual consultative groups that might be mandated by the transatlantic political leadership at their summits or otherwise. If it were staffed by close personal representatives of the political leaders, as would be essential at least at the outset of the operation, it could also infuse “political will” and even do some trouble-shooting on its own when individual groups become bogged down by parochial problems peculiar to their topics.

Duplication with other international groups?

A final question that has been raised about the G-2 idea is whether it would duplicate existing groupings.

All of the other “Gs,” certainly including the G-7/8 and the formal international institutions like the IMF and WTO, would continue to exist.

To the extent that the G-2 became an effective steering committee, the existing organizations would in fact function more successfully. They would also become more significant themselves, by bringing the G-2 decisions to the next circles of leadership and carrying out agreed policies.

In particular, however, with the demise of Japan and the limited weight of Canada and Russia on most global economic issues, isn't the G-7/8 already essentially a G-2, thus obviating the need for anything new?

The answer to that question is a resounding “no.” First, the G-7/8 does include three countries that are of marginal relevance for most major international economic issues (Canada, Japan, Russia), which complicates its discussions and makes agreement more difficult.

Second, the presence of four European countries plus the Commission reduces rather than enhances the prospect of a common European position; the G-7/8, has ducked rather than confronted that fundamental problem in achieving meaningful coordination.

Third, the G-7/8 summits often lack substance and have become political rather than economic conclaves to the extent that some substance does survive.

Fourth, the “finance G-7,” which escapes some of the shortcomings of the summits, has also become ineffective because its members do not to criticize each other and because of their resignation to inertia in the face of “overwhelming market forces” and the independence of their central banks.

Fifth, none of the G-7/8 variants even address some of the most critical issues on the list suggested above, such as migration and environmental policy.

The final and central policy question is of course whether a new G-2 could overcome these problems that have come to hamstringing the G-7/8 (and other international bodies) so severely in recent years. The honest answer is that it could do so only if launched with strong political commitment on the part of the top political leaders on both sides of the Atlantic and then implemented, on an ongoing and sustained basis, by officials with the same dedication.

The model is of course the American and European unions themselves: both overcame enormous odds due to the compelling nature of the gains from “deep integration,” political even more than economic, and implementation by a cadre of enthusiastic supporters of the concept.

Similar conditions will need to be met if a G-2 is to flourish in the early part of the twenty-first century. The driving elements would have to be a conviction on the part of both American and European leaders that their own relationship required a firm new foundation, that they needed to protect themselves from some of their own worst proclivities (unilateralism in the United States, insularity in Europe) and that they could only exercise their responsibilities for global leadership by acting together in a much more concerted manner.

All three make a strong case for launching the G-2 initiative at the earliest possible time.