THE UNITED STATES AND THE EUROPEAN COMMUNITY:

THE CHALLENGES AHEAD

SPEECH GIVEN JUNE 19, 1981

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INTERNATIONAL BANKING CENTER
MIAMI, FLORIDA

AJD
6/19/81

When I first accepted your kind invitation to come to Miami to speak on the United States and the European Community: the Challenges Ahead, I thought that this would be in the nature of an exercise in forecasting.

As it is, there are certainly challenges ahead but I suspect that they are going to be a continuation of challenges that are already with us, particularly in the fields of economics and trade. Were they not met and properly dealt with, they could, in time, threaten not only the economic partnership that exists between the United States and the European Community, but also the economic and political unity that we are building up in Europe.

Boiled down to their essentials, the two major problems we face are these: first, how to reconcile the new economic policy being pursued in the United States with the effects it is having in Europe - and second, against the background of the Community's $25 billion trade deficit with the United States, how to manage our trade relations in a way that ensures we avoid a future confrontation.

These are the two challenges that I would like to go into with you today, I do so because they are immediately before us and have to be dealt with as a matter of some urgency.

At the same time, we should not allow them to obscure our vision of other problems that still lie ahead.

Let me spend just a moment to mention them in case they are forgotten in the hurly-burly of the present.

There is the whole question of what is known as burden-sharing; of who does what and who spends how much on ensuring our collective security. This encompasses not simply military preparedness and defense but also the whole question of foreign aid.

In the European Community we in general see economic aid as a means toward promoting orderly economic development in less developed countries and thereby contributing toward political stability in the developing world. We also see it as being in our own economic self-interest to help develop the economies of these countries, important as they are to the western world, both as sources of raw materials and as a market for our own products.

The United States does not share this view to the same extent. Indeed present policy appears to favour limiting what are already, relative to our own contributions, fairly low levels of development aid.

This need not necessarily be a cause for frictions between us, so long as it is recognised in the whole debate over burden-sharing that, although what one is doing may be different, the aims and the objectives are going in the same direction.

It applies too on political issues such as the Middle East and southern Africa.

On such issues Europe speaks more and more with one voice. This voice will not always be a perfect echo of American utterances on the same subjects.

That is why genuine consultation must take place and must be seen to occur. And by consultation I mean each asking the other for his point of view and then taking it into consideration before taking a final decision. By consultation I do not mean information of a final decision just prior to its implementation.

But, to return to the immediate challenges that I mentioned at the outset of my remarks, let me deal first with the economic problem. One would need to be a Rip van Winkle not to know that the United States has set sail on a new economic course.

The objectives of the U.S. policy are to bring down inflation, to increase the growth rate, thereby insuring a stable and sustained development of the U.S. economy.

Given the pivotal position of the United States in the world economy, we in Europe cannot but applaud these objectives.

We have everything to gain from America's restored economic strength. If inflation is brought under control in the United States, it makes it that much easier for us to wrestle with the same seemingly endless spiral. If American industry invests and produces efficiently, we shall share in the economic growth that follows.

Four principal means are being employed to attain these objectives: cuts in public expenditure, limited growth in money supply, tax reductions and deregulation in general.

The objectives are laudable; the instruments effective; the time propitious.

Indeed, the U.S. Government is considerably assisted in implementing its policy by favourable external factors, such as in particular the current reduction in oil prices.

And yet why do we hear questioning and criticism abroad? It is for none of the reasons I have mentioned but reflects certain fears, because domestically and immediately, the U.S. Government appears to be laying great emphasis on the control of the money supply. The consequence of this is the very high interest rates that we have been experiencing for some time now in the United States.

High interest rates in the United States such as those we have experienced over the last 18 months mean rising interest rates in Europe where they have reached levels which can be tolerated with increasing difficulty over time because they limit the margin of maneuver of the authorities who have to deal with an ever-deepening economic crisis.

Right or wrong, our concern in Europe is that interest rates may remain high in the U.S. for some considerable length of time as the new economic policy is implemented.

The effects of this are very detrimental in Europe, where the rate of growth of the economies appears to have been far more affected by high interest rates over the last two years than in the U.S.. Thus, investment would continue to stagnate, we will continue to experience zero and even negative rates of growth and our unemployment rate will continue rising possibly to reach intolerable levels.

Indeed we are seeing this happen already. Because of existing high interest rates in the United States we have the situation where, in certain member countries, a ten point gap exists between the rate of inflation and current rates of interest. This is reflected in a current unemployment rate of more than 10%, a rising budget deficit and a negative growth rate.

In the European Community as a whole, the unemployment rate now stands at 8% -- the highest level since the 1930s. On present trends it is likely to reach 10% in the coming year.

In the United States, it is generally agreed that with a 4%-5% unemployment rate, you in fact have full employment.

In Europe, where in particular frictional unemployment is much lower than here, we generally accept full employment as meaning 1% or less unemployed. This therefore implies that the level of unemployment is much higher than in the U.S. already and may soon, on a comparable basis, be close to the double you have here.

What is more, an alarmingly high proportion -- 43% -- of the Community's jobless are young people under the age of 25.

These are not just cold economic facts. They rapidly translate into social and political facts of a somewhat higher temperature.

The consequences of young people entering the job market for the first time and finding they are not welcome in it should be given some consideration.

One should not be surprised that these same young people may be less willing than is normal at such an age to accept traditional values and political beliefs. One should equally not be surprised that societies that cannot provide employment for an increasing percentage of their able population may be less willing to accept added financial burdens to ensure their defense and security. Indeed, the high cost of servicing the debt in a number of member countries has reached such levels that authorities are facing unpalatable choices between cuts in social benefits which for the above mentioned reasons are difficult to envisage, or a reduction in the defense effort.

Such social and political consequences would not, in any way, serve the interests of the Western Alliance as a whole. A Europe that is economically weakened is a Europe that is politically weakened. It is a Europe that would be less able to play a constructive role in meeting the major challenges of this decade: challenges that the United States would, I am sure, wish that we meet together with them.

So to come back to what is at the root of the problem: high interest rates and the fear that the U.S. monetary policy may mean that we have to live with them for a fairly long time to come.

The question for us in Europe, and it may become one for the United States, is how to bring interest rates down without abandoning the fight against inflation. As I said earlier, we continue to applaud the objectives of the Administration's economic policy.

It is the spillover effect in Europe of the means that are currently most relied upon to achieve these objectives that is the problem.

In other words, our concerns would be alleviated if the policy mix were such that interest rates show real signs of abatement in the near term.

This, I understand, implies therefore on the one hand a gradual and, I hope, even a sharp rise in the propensity to save which at the moment is very low -- a third or less than what it is in Europe or Japan -- as well as a progressive reduction of government calls on the money markets, which implies a real reduction in the budget deficit.

Even if there were signs that interest rates were falling, it would not, however, mean that all our concerns over monetary policy were removed. There would remain the problem of exchange rates and the question of whether the United States was prepared to intervene, when necessary, in the markets to maintain a measure of international currency stability.

We all know the consequences of volatile movements in exchange rates. This is why, traditionally, central banks have been prepared to step in from time to time at moments of difficulty or crisis to support one another's currencies, to deter speculation and to avoid violent fluctuations in exchange rates.

Recent statements seem to indicate that the United States is now inclined to follow a policy of non-intervention in this field. This would constitute a departure from traditional practice. This may, however, make it more difficult for the other countries in the Western World to insure an orderly functioning of exchange markets.

In the Community, in particular, the member countries have, for just over two years now, been operating and developing what is known as the European Monetary System. Through such a system, we are creating a zone of monetary stability in Europe with obvious benefits to business and industry.

It is also worth noting that the existence of this system implies a degree of cooperation between our governments that reinforces the economic unity that we are gradually building in Europe.

In the long run, such a system, if strengthened and developed, carries with it two corollaries: in the first place, it would encourage a gradual harmonisation of the economic policies of the Member States of the Community and simultaneously become the starting point of a European currency which would have an important role to play in contributing to a more stable world monetary system. But this is not the moment to expand on perspectives which have been so eloquently described by such distinguished economists as Professors Triffin, Mundell and others. In the meantime, however, that is today, the main world reserve currency remains the U.S. Dollar. Any economic crisis in one or more of our Member States could lead to disruptive effects on the exchange markets. One would then, like in the past, see the other central banks in the Community intervene to smooth out such temporary disturbances.

The effectiveness of such intervention is however less great in a situation where the U.S. authorities would take a "hands-off" attitude.

To the extent that such interventions are less effective, this would mean that grave strains would be imposed on the European Monetary System; these, over time, could lead to its survival being put into question.

None of what I have said about the effects of U.S. economic policy in Europe precludes the necessity of facing up to and dealing with the challenge of our own economic problems. The point I wish to make, however, is that our efforts to do so are not assisted by the additional burdens that U.S. economic and monetary policy is currently, and perhaps unwittingly, thrusting upon us.

The repercussions of the preceding developments are felt in many areas, particularly in the trade field. High interest rates contribute in no uncertain way to the worsening economic situation in Europe.

It becomes increasingly difficult on our side to resist demands and pressures for protection from those firms and workers who seek relief from import competition, or see their access to traditional export markets limited. The U.S. and the European Community are each other's major customer. In 1980, the U.S. exported to the E.C. $62 billion worth of goods, whereas the E.C. exported $37 billion worth to the U.S., leading to a U.S. surplus of $25 billion.

Partly because of agricultural trade, where again, we are your major customer, the United States has enjoyed a large and growing surplus in its trade with the Community.

From our point of view, our trade deficit with the United States in the past has been something we could reasonably live with.

However, in the past year, our deficit with the United States has more than doubled to $25 billion; more than twice the deficit that the United States or the E.C. has with Japan.

It is inevitable that, against the background of a sharply rising deficit of this magnitude, one would see protectionism rearing its ugly head. In spite of all these factors playing against us, we have remained faithful to the free-trade philosophy which constitutes a basic corner stone of the Common Market.

So far, we have been able to hold the line and we earnestly hope to be able to continue doing so.

Trade restrictions would be in no one's interest, least of all would it be in the interest of the United States, in view of the surplus it enjoys with us.

It is therefore a little surprising for us to be hearing the language of trade warfare being uttered on more than one occasion recently by high-ranking U.S. officials.

It is all the more surprising as we are not aware of there being any major complaint about any trade measures or practices by the Community other than on the question of export credits.

One might understand a complaint that a $25 billion surplus was having an inflationary effect on the U.S. economy, due to the increased income generated and the reduced availability of goods on the domestic market.

One does not hear this complaint, least of all, of course, from the one million U.S. workers whose jobs exist simply because of this surplus.

And yet, not to put too fine a point on it, we are being addressed in public in a language that is not only tough but uncompromising.

There are and probably always will be points at issue between us in our trade relations. The history of our commercial relationship shows that such points can be resolved by patient diplomacy and negotiation. As a matter of fact, the last decade was very successful in achieving great progress toward further liberalisation of world trade.

This cannot be done if either party decided to travel the road of confrontation. It is a very narrow road that allows little room for flexibility or maneuver. Once you are on it, there is very grave danger of collision with untold damage being done to all who are involved.

I do not believe that we have taken that road. I strongly hope that the tough language I have referred to does not indicate that there are some who may wish to.

They should be aware of the full implications. Between us, the United States and the Community account for roughly half of all world trade. If the rhetoric we hear of trade warfare is translated into action, the consequences would be difficult to assess.

The irony is that this type of economic warfare could well be sparked off by one relatively insignificant and avoidable issue.

Take that of export credits for example. The American complaint is that Europe is reluctant to raise interest rates on export credits. This has prompted some fairly strong language by senior U.S. officials.

Yet, it is a dispute which, to return to a point I made earlier on monetary policy, would disappear overnight if U.S. and European interest rates generally were to return to sensible levels.

I have tried to deal in these remarks with what I see as the principal challenges facing us in the economic and commercial fields.

I would not like it to be thought that these questions can be considered in isolation from the political relationship between the United States and Europe.

It would be a great mistake to believe that, if there were turmoil in our economic relations, that there could continue to be sweetness and light in any other relationships. It is with the good of our collective well-being and security in mind that I have chosen to speak to you with some frankness on these issues today.