CENTRE FOR
EUROPEAN
POLICY
STUDIES

CEPS POLICY BRIEF NO. 20
APRIL 2002

EUROPE AS A GLOBAL ECONOMIC ACTOR

DANIEL GROS

CEPS Policy Briefs are published to provide concise, policy-oriented analysis of contemporary issues in EU affairs. Unless otherwise indicated, the views expressed are attributable to only the author and not to any institution with which he is associated.

EUROPE AS A GLOBAL ECONOMIC ACTOR

CEPS POLICY BRIEF NO. 20

DANIEL GROS*

The three years since the start of EMU have been characterised by an extraordinary degree of volatility in global financial and other markets (oil, etc.). Most official comments have so far focused on the fact that Europe has remained an 'island of stability'. But this self-congratulatory tone cannot mask the fact that EU institutions have generally not been in the forefront of the efforts to stabilise the global economy. This is partly understandable as most of the volatility originated outside the EU. But just 'putting one's own house in order' does not seem to be sufficient when global economic (or political) stability is at stake, as recent events amply demonstrate.

This note will concentrate on two particular aspects of this issue, namely 1) the absence of the EU in the efforts to contain emerging markets' volatility and 2) the inability of the EU to develop a coherent strategy for the use of its economic instruments in the Middle East.

1) Over the last years the sharp swings in capital flows to emerging markets, which trigger recurrent financial and banking crises, have constituted an important source of financial instability. As these crises have at times affected global financial stability (Asia, Russia) and have often directly affected EU interests, it is surprising that the EU has been completely absent in the variety of efforts to deal with this phenomenon – at least in comparison with the US. The attitude of the EU has so far been one of complete passivity. Since there is no direct EU competence involved, the issue is left to individual member states, which act according to their own perceived, national interests.

The result to date has been that no coherent EU position has been developed and defended, even in cases where Europe's strategic interests are clearly implicated, e.g. Turkey. By contrast, the US authorities usually have well defined interests and views, and appear to be so effective in influencing other institutions that at times it seemed as if the IMF was taking orders from the US Treasury.

A similar process appears to be operating in the current discussions about the desirability of establishing orderly bankruptcy proceedings for emerging markets facing debt problems. According to recent press reports, the key to a solution is the US position.

The EU is also not using its financial muscle (or rather the financial means of its member states) in an efficient and concerted way. The EU plus the 15 member states together provide much more official development assistance than the US. But one would be hard pressed to mention a single case of a non-European country of strategic importance whose position has been swayed or heavily influenced by European aid.

There exists one EU instrument for directly channelling financial aid, the so-called Macro-Financial Assistance (MFA). But this facility is limited in size and has de facto been only

* Director of CEPS. This Policy Brief is a revised version of a note prepared for the Aspen European Dialogue, Venice, 6-7 April 2002.

available for a small group of countries (mainly in Europe). For the few favoured recipients, MFA is important despite the fact that it represents only a fraction of the total received from member countries either directly (on a bilateral basis) or indirectly (via the IFIs). The main instrument of the EU's 'financial foreign policy', the Macro-Financial Assistance, is thus only of limited use.

Why has the EU been invisible in efforts to resolve emerging market crises? Much of the answer must be that the responsibility for fiscal policy and financial supervision remains largely in national hands. The Maastricht Treaty was essentially inward-looking, paying great attention to the distribution of competences within the EU, but ignoring almost completely the external dimension. The fact that there are no direct EU competences implies that any attempt to organise an EU input to efforts to resolve international financial crises would require a very complex institutional set-up. Bundling national financial assistance could in theory be achieved through informal coordination, but reality has shown that member states guard jealously their 'sovereignty' in financial affairs. This is also the main reason why there is no institutional mechanism to coordinate bilateral aid or positions at the IMF (as well as in other IFIs).[1] The latter is especially important as it deprives the EU of crucial leverage; after all, the sum of the quotas of EU-15 (or even the eurozone) is at around 30% – much larger than the US quota (around 20%) in the Bretton-Woods institutions, IMF and World Bank.

Why this area is left to member countries can be explained by two distinct phenomena:

i) The *small country syndrome*. No individual member country on its own can hope to have a decisive influence on the global scene. There is therefore little incentive at the member country level to spend the resources required to make policy proposals or participate actively in the debate. Given the technical and analytical expertise that is required in this area, an active participation in the policy process is possible only for countries that develop and maintain a highly qualified staff over long periods.

ii) *Dis-economies of scale*. As smaller member countries cannot have finance ministries of the same size as the US, it is clear that their officials cannot specialise to the same extent. The manpower employed in the international departments of the 15 member states greatly exceeds that employed by the US Treasury, but the work of all these European officials is not coordinated and they often work at cross purposes, as they are driven by domestic political and economic agendas.

In order to illustrate the practical difficulties that do not allow the EU to act, it is useful to go through a concrete example. What would it take to establish an 'EU' position in a particular crisis, e.g. Turkey or Argentina? This would require the co-operation of the ECB, national ministries of finance (via the Economic and Financial Committee and ECOFIN), the Commission and probably the European Parliament. None of these institutions operates with a strong foreign policy background. Last, but certainly not least, the EU did not, until recently, even have to pretend to have a common foreign policy. This has now changed, and the EU has a foreign policy chief, but this person (and the office he represents) has no standing in the 'competent' bodies (mainly the EFC and ECOFIN). Finance Ministers have a tendency to be a law unto themselves in any event. They become especially reserved when their colleagues from the Foreign Ministries try to invade their area with other concerns. This is another difference with the US where the Treasury does take foreign policy considerations into account.

[1] Informal efforts in this direction in the context of the Economic and Financial Committee (EFC) have so far not led to any appreciable results.

The case of Turkey illustrates clearly all the potential economic and political costs and benefits. The joint banking and foreign exchange crisis that started in 2000-01 still poses a risk of a breakdown of the social fabric. The tension seems to have subsided in early 2002, but the danger remains. The EU could have played a key role in easing the financial plight of the country, but this was never even considered. Member countries and the EU institutions were quite content to leave the management of this crisis to the experts, i.e. the IMF. Given that there is no EU expertise, nor any competence, to deal with these crises, this might have been unavoidable. As there is no hint of a change of the situation in the foreseeable future, however, one must conclude that for the time being the EU is not really an actor on the global financial scene.

2) One might be tempted to argue: Why care about the fact that the EU has no pretension to shape the global financial system? Would this affect the welfare of European citizens? It is true that European citizens might not be much better off if crises in emerging markets were solved by means of a model in which the European Union has a say, rather than one dictated by the US alone. But there are other cases in which EU's interests are more directly at stake and where US and EU interests (or rather strategic approaches) differ sharply.

The deepening crisis in the Middle East is providing yet another illustration of this incapacity of the EU to act in a coherent way. The EU is the most important trading partner of most countries in this region, including Israel, with which it has strong economic relations (trade in both directions is running at around $10 billion p.a. – see table below).

EU Trade with Israel, 2000				
	EU Imports ($ mil.)	Share (in %)	EU exports ($ mil.	Share (in %)
Agriculture and Processed Foods	818	8.41	562	3.69
Fuels	262	2.69	344	2.26
Pharmaceuticals	399	4.1	345	2.27
Chemicals	1,432	14.72	1,663	10.92
Textiles, Clothing, Footwear	515	5.29	570	3.75
Jewels, etc.	1,995	20.5	3,923	25.77
Engineering	2,763	28.79	3,889	25.54
Equipment	804	8.27	2,058	13.52
Other	744	7.64	1,871	12.28
TOTAL bilateral trade	**9,731**		**15,226**	
Memo item	Israeli exports		Israeli imports	
Total bilateral as % of total Israeli trade:	**31.5 %**		**44.5 %**	

This trade is governed by an Association Agreement, which contains a clear reference to the respect of human rights. Should the conflict escalate further, this article might have to be invoked. The EU is also one of the main financial backers of the Palestinian Authority, to the tune of several hundreds of millions of euro to date. The EU has thus certainly considerable economic leverage over both parties. This leverage has arisen as a by-product of disparate policy initiatives, with little thought being given to whether it fits into a larger foreign policy strategy. But before the EU can even consider using the economic instruments at its disposal (trade preferences and financial aid, both cases of which are clearly an EU competence) it should first make up its mind about what it wants. Just calling for peace and repeating the mantra that UN resolutions should be implemented does not constitute a coherent policy. What is needed is a clear formulation of the concrete actions the EU might undertake and how it would react to an escalation of the conflict, regardless of its source. But no such plan of action has been considered.

This is another example of the disappointingly modest ambitions of the EU to establish a common foreign and security policy. It might not be of great importance for the future of Europe whether the EU can participate actively in resolving the financial crises of emerging markets, but an all-out war in the Middle East poses serious risks to the vital interests of Europe.

Conclusions: All in all, it appears that the EU will remain largely a non-actor on the global financial and economic stage. Compared to Japan, it can take consolation in the knowledge that it has at least its own house mostly in order. But the EU remains ill-equipped to make an active contribution to global financial stability. The EU is now developing its own rapid reaction force, but nothing similar is even being thought of in the financial field. If the EU is to be able to co-direct the global financial system together with the US, it must develop its own expertise (‘planning assets’) in this field and create a mechanism to quickly mobilise the vast financial resources of its member states.

Recent events in the Middle East have underscored how irrelevant the EU has become for both parties. This can be changed rapidly only if the economic constitution of the EU is amended to allow for the coordination of the available economic instruments with the (hopefully strengthened) CFSP.

About CEPS

Mission

The Centre for European Policy Studies is an independent policy research institute founded in 1983:

- To produce sound policy research leading to constructive solutions to the challenges facing Europe.

Goals

- To achieve high standards of academic excellence and maintain unqualified independence.
- To provide a forum for discussion among all stakeholders in the European policy process.
- To build collaborative networks of researchers, policy-makers and business across the whole of Europe.
- To disseminate our findings and views through a regular flow of publications and public events.

Assets and Achievements

- Quality research by an international staff of 30 drawn from fifteen countries.
- An extensive network of external collaborators, including some 35 senior associates with extensive experience working in EU affairs.
- Complete independence to set its own priorities and freedom from any outside influence.
- Ability to anticipate trends and to analyse policy questions well before they become topics of general public discussion.

Programme Structure

CEPS is a place where creative and authoritative specialists reflect and comment on the problems and opportunities facing Europe today. This is evidenced by the depth and originality of its publications and the talent and prescience of its expanding research staff. The CEPS research programme is organised under two major headings:

Economic Policy
Macroeconomic Policy
European Network of Economic Policy
    Research Institutes (ENEPRI)
Financial Markets and Institutions
European Credit Research Institute (ECRI)
Trade Developments and Policy
Energy for the 21st Century
Efficiency in the Pursuit of Collective Goals

Politics, Institutions and Security
Political Institutions and Society
The Wider Europe
    South East Europe
    Caucasus and Black Sea
    EU-Russian Relations
The CEPS-IISS Security Forum
South East European Security Cooperation
Justice and Home Affairs

In addition to these two sets of research programmes, the Centre organises a variety of activities within the CEPS Policy Forum. These include CEPS working parties, the lunchtime membership meetings, network meetings abroad, board-level briefings for CEPS corporate members, conferences, training seminars, major annual events (e.g. the CEPS International Advisory Council) and internet and media relations.

Centre for European Policy Studies
1 Place du Congrès
1000 Brussels, Belgium
Tel: 32(0)2.229.39.11 Fax: 32(0)2.219.41.51
E-mail: info@ceps.be Website: http://www.ceps.be