Trade, Technology, and Human Capital

The United States and Germany in a Contested Global Economy

Geo-Economics Group Presentation
The U.S. and Europe share the largest bilateral economic partnership on earth, measured by trade (over $3.75 billion a day in two-way trade), investment, job creation (over 16 million jobs directly created through investments or indirectly supporting imports and exports) as well as data flows and Internet traffic.

The bilateral relationship is also at risk, primarily due to rising tariffs and retaliation, the threat of additional U.S. tariffs on imported autos and auto parts in the name of supposed “national security” concerns, and with the impending breakdown of the dispute settlement system at the World Trade Organization.

Both sides must urgently work together to find ways to improve and strengthen—rather than undermine—this valuable and essential economic partnership.
In light of a common challenge from a rising China, transatlantic cooperation to defend our model of democratic capitalism is urgently needed. The WTO system needs to be updated and reformed to better deal with state-owned enterprises and the interventions of national governments into business. China’s model of forcing technology to be transferred and shared with local partners presents an existential threat to Western intellectual property, and its refusal to open up sectors of its economy to competition is a growing concern.

The U.S. and Europe share a vision of how markets should be fairly and transparently regulated, with fair and equal treatment for domestic producers and international investors alike. We should work together more closely with other like-minded partners including Japan, Canada, and others to push China to follow the rules and remain within the international economic system that it has greatly benefitted from over the past 30 years.
“Cooperation within Conflict”

1. Focus on the big picture
2. Don’t let the perfect be the enemy of the good
3. Do not imitate, innovate!
4. Get your house in order

Though we missed a unique opportunity to build a more integrated transatlantic economy during the recent negotiations for a Transatlantic Trade and Investment Partnership, Europe and the United States should still work together to build a positive trade agenda. As the current trade tensions have underlined, the lack of a formal trade agreement is harming business certainty and undermining growth potential.

The two sides should work together to urgently remove industrial tariffs on goods traded across the Atlantic, as well as establish effective frameworks for regulatory cooperation to remove unnecessary nontariff barriers to trade.

Moreover, in face of a common threat from a rising China, the U.S. and Europe need to work together now to present a united front and alternative scenario for the emerging markets which may believe the Chinese model offers some compelling advantages. In that light, efforts to “reform” industrial and competition policy in either Europe or the United States to give governments more of an influential role through direct subsidies or the promotion of anticompetitive mergers must be avoided. We shouldn’t try to “out-China” the Chinese. We need to stay true to our values and let the market, not governments, choose winners and losers.
Future of Trade: The End of Multilateralism?

- The multilateral world order is increasingly challenged

As the markets have shown in recent weeks, the U.S. market cannot sustain a trade war fought on multiple fronts. The U.S. needs to work with, not against, its allies to find sustainable solutions to deal with China and reform the WTO.
Future of Trade: A New Transatlantic Approach to Trade

- Recommendations:
  - Find areas of common ground and make forward progress
  - Develop common norms and standards and the elimination of (non-tariff) trade barriers
  - Demand and enforce reciprocity to ensure a level playing field
This may be our last best chance as the world’s two leading economies to set standards together. If we fail to do so, both Europeans and Americans will be forced to contend with Chinese standards and more countries adopting the Chinese economic model.

Let’s focus on the areas we agree on, rather than insisting on removing all barriers to trade between us. If we can’t agree on agriculture or autos trade today, let’s sign something and commit to a common dialogue moving forward.

In the regulatory sphere, the U.S. and Europe should commit to a process of dialogue so that if and when we diverge on regulatory policy, it is at least done intentionally. Limiting divergences between us will help present a common approach to the rest of the world.
Digitalization represents a central test, and an important opportunity, for the transatlantic relationship for three reasons.  
1). The depth of its economic impact  
2). The breadth of its impact across sectors  
3). The evolution of the space over time.

There are several growing digital divides across the Atlantic—namely on tax and privacy policy. The U.S. and Europe should commit themselves to finding a joint multilateral solution at the OECD to define how to change the international tax system to account for the digitalization of the economy.

On privacy, the EU should work with business and civil society partners to review how its General Data Privacy Regulation is being applied and whether it is achieving its primary objectives. There may be a need for targeted reforms to ensure that citizens’ personal data privacy is protected, but also ensure that innovation can succeed. If the Regulation simply entrenches the largest digital actors, it will only entrench Europe’s digital divide and its lack of global leadership in the tech sector.

Similarly, the U.S. should learn from the European experience as it pursues a federal data privacy policy and as U.S. states consider their own solutions.
Three opportunities emerge for transatlantic cooperation.
1). Build off existing foundations
- The transatlantic relationship has an almost 70-year history of cooperation and coordination. This history can and should be leveraged to begin to address emerging and future challenges.
- Recommendation: leverage prior transatlantic joint engagement in trade and investment to set rules for the road for the digital economy.
2). Do not lose sight of the forest through the trees
- It can be all too easy to become bogged down in tactical and operational facets of particular issues, which are often complex both in terms of diagnosing the problem and in terms of identifying politically viable solutions. However, these narrower issues are part of a larger geopolitical picture that should remain at the forefront of transatlantic cooperation. In discussions of potential solutions, areas of disagreement should be identified in a structured, intentional manner to avoid unintentionally undermining those shared goals.
- Recommendation: create a regulatory dialogue to avoid balkanization of cyberspace.
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For more information refer to Melissa K Griffith’s publication entitled “The Geoeconomics of Digitalization: Future Proofing the Transatlantic Relationship” completed for the Geoeconomics Working Group as part of the American Institute for Contemporary German Studies’ (AICGS) “A German-American Dialogue of the Next Generation Global Responsibility, Joint Engagement” project.

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We can only present a credible alternative to Huawei and the Chinese state-owned enterprises (with their attendant privacy and intelligence concerns) through effective transatlantic partnership.
Future-Proofing of the Workforce

- Challenge: an increasing skills gap in advanced economies
Future-Proofing of the Workforce

- Recommendations:
  - Identify the skills needed for the economy of tomorrow
  - Create and deepen alliances between stakeholders
  - Insulate and re-train the workforce
Future-proofing the workforce, and the economy in general, does not only require smart policies but it also requires money. However, one challenge that we identified in this group is that both Germany and the US have an acute shortfall in investment.

The graph shows gross capital formation in percent of GDP in Germany and the US since 1970. It shows that over the last four decades we have seen an steep decline in gross capital formation in both Germany and the US, and that today gross capital formation in these two countries is clearly below the OECD average.

In recent years, there has already been much talk about the need for governments on both sides of the Atlantic to increase investment but not enough has been done. The fiscal priorities have been elsewhere: in the US, the Trump administration has prioritized tax cuts, the impact of which have not only been regressive but also short-term and pro-cyclical; in Germany, the Grand Coalition in contrast has prioritized fiscal consolidation by balancing the budget and celebrating the Schwarze Null. In both countries, this meant that money for long-term investments is missing: public schools are failing, trains are not running, and swimming pools are closing.
Figure 1: Percent Change in After-tax Income of the Conference Agreement for the Tax Cuts and Jobs Act by expanded cash income percentile, 2018, 2023, and 2027.

To address this problem, Germany and the US need to get their house in order. This entails three things:

First, both countries should develop large-scale investment projects that increase human and physical capital in order to safeguard the economic competitiveness of the transatlantic economy in the future.

Second, they need to reconsider the domestic macroeconomic policy priorities: they need to reconsider whether it is really important to give tax cuts to the rich or whether it is really important to reduce government debt.

• Oliver Blanchard from the Peterson Institute recently argued that government debt is not as costly as generally assumed in times of low interest rates. In Germany, in fact, long-term interest rates on government debt just turned negative again, meaning that effectively private investors are ready to subsidise public investments.

Third, it is also important for policy-makers to create policy space to respond to the slowing of the global economy. We know that there are a large number of economic uncertainties, especially in Europe where the biggest unknown at the moment is
probably Brexit. In this context, policy-makers should already consider now how they could respond to a slowing of the global economy and create the appropriate policy-space to do this. Given that the balance sheets of central banks are still bloated, this will probably have to be done via fiscal policies and therefore this recommendation also implies that policy makers should rediscover fiscal policy as a mechanism for macroeconomic stabilization.
In conclusion, this group identified several areas where Germany and the US have to get their house in order. However, there are also many other areas where there are important synergies that the transatlantic partners could create, and there are yet again several areas where it is absolutely crucial for both sides of the Atlantic cooperate.

We firmly believe that such cooperation is not only necessary to overcome the challenges that we identified in the contested global economy, but they would also help us to build trust, reinforce shared values and thereby create even more opportunities for cooperation!