FEATURE

President Bush's recent visit to Europe was billed as heralding a fresh start for transatlantic relations. But there is one area where the tensions of recent years has had surprisingly little impact on the relationship. **Philip Gordon** reports

THE DOG THAT HAS NOT BARKED

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During the Cold War, strategists constantly fretted that transatlantic economic disputes would undermine the political foundations of the Atlantic Alliance.

Differences over agricultural subsidies, trade protection, investment rules and currency policy, they feared, would lead to political tensions so great that they would sap the solidarity on which NATO depended, possibly even leading to a departure of American troops from Europe that would leave the continent vulnerable to Soviet attack.

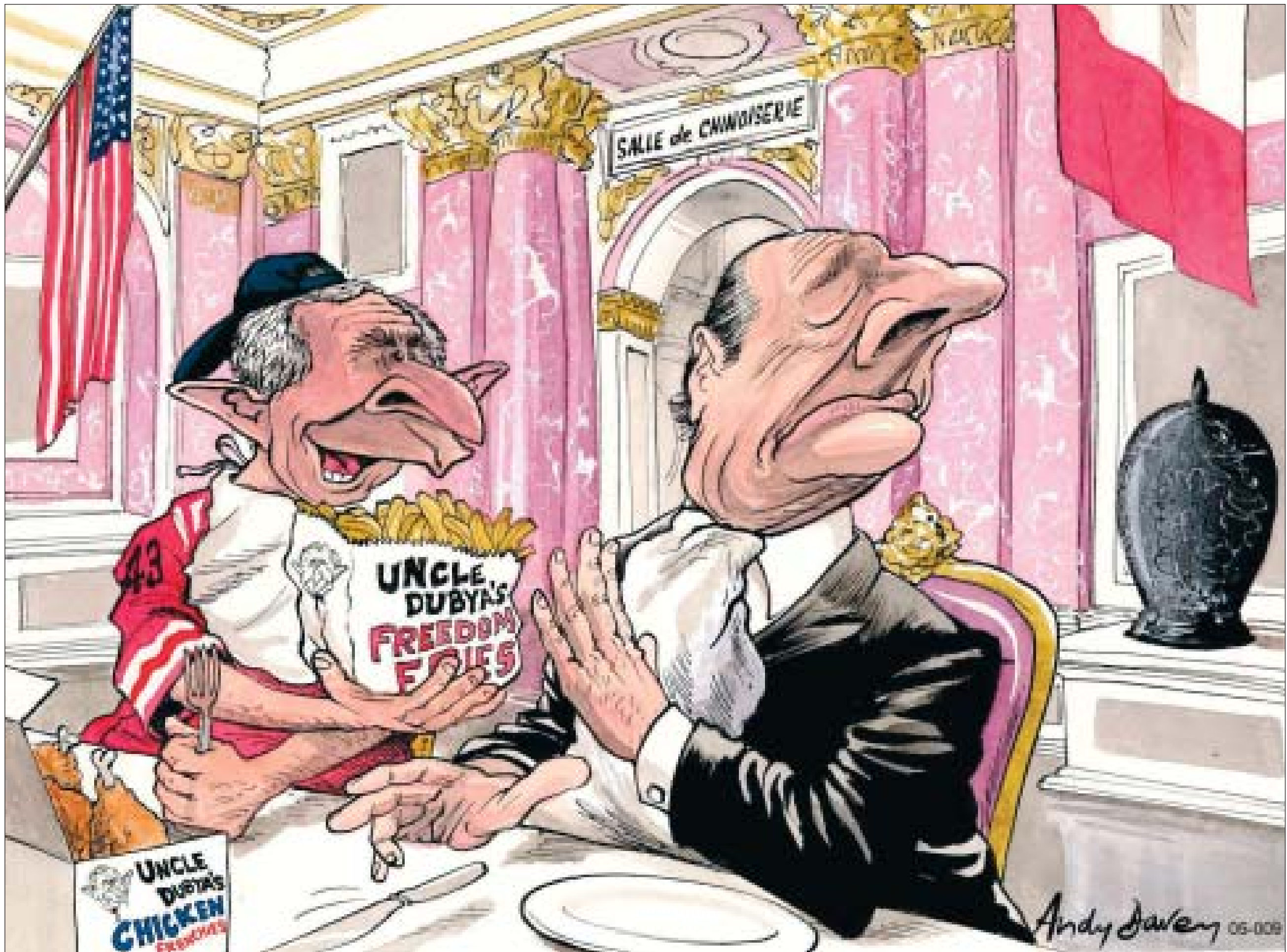
In the end, the alliance survived. Repeated and sometimes quite fierce economic disputes came and went, but the West held firm and eventually won the Cold War. In retrospect, the reason was simple: both America and Europe had a profound, mutual stake in their political and security alliance, and both realised it would be folly to put that interest at risk over textile tariffs or subsidies for milk.

Today, the concerns about 'spillover' between politics and economics seem to have reversed. Now, it is mostly business leaders who worry that the transatlantic economic relationship will be affected by political tensions, not the other way round. And while no one should be complacent about US-Europe economic ties at a time of political turmoil, recent experience suggests the new worries may be as misplaced as the old ones. For the reality is that despite the real and deep transatlantic political crisis of the past several years, the US-Europe economic relationship has not faltered, but flourished.

Certain businesses – especially those that rely heavily on foreign government decisions on issues like public procurement or technology transfer – can indeed suffer when the overall relationship deteriorates. But the transatlantic trade and investment relationship is remarkably robust and surprisingly immune to political tension. And nothing demonstrates this better than developments over the past four years.

First, just consider the facts. Since George W. Bush's election in November 2000, political relations between the US and Europe have arguably gone through their worst patch since the western alliance was formed. Even before the Iraq crisis, Bush's policies on issues like climate change, missile defense, the International Criminal Court and even the death penalty made him extremely unpopular in Europe, and caused the US image there to plunge.

Then came the Iraq war, which was opposed by large majorities of European public opinion and led to some of the



Cartoon: Andy Davey/www.andydavey.com

largest street protests against US foreign policy ever seen on the continent.

By 2004, polls showed that European support for US global leadership had declined precipitously in all the major European countries (by an average of over 20 points between 2002 and 2004 in the UK, France, Germany and Italy) and that a majority of Europeans now want Europe to "take a more independent approach from the US in security and diplomatic affairs". Pundits concluded that when it came to foreign policy, Americans and Europeans were "living on different planets".

The effect on the transatlantic economy? If it was negative, the damage is far from apparent. For far from deteriorating along with the political ties, US-Europe economic relations have only become stronger during the past four years.

As Joseph Quinlan and Daniel Hamilton showed in a recent study of transatlantic economic trends, *Partners in Prosperity*, transatlantic trade, investment, and foreign-affiliate earnings are all booming. The total trade in goods, for example, rose by 12% between 2000 and 2004, from $422 billion to an estimated $475 billion.

Even more important, the political strains hardly seem to be interfering with investment decisions. More than 60% of US foreign direct investment (FDI) since 2000 has gone to Europe, including a record of nearly $100 billion in 2003, and the sums are still increasing. In turn, Europeans invested some $37 billion in the US in 2003 and European FDI now accounts for nearly three-quarters of all foreign investment in the US.

Finally, transatlantic foreign affiliate sales, which amount to more than double transpacific foreign affiliate sales, also continue to rise. Sales by US affiliates in Europe, for example, rose by some 25% to more than $82 billion in 2003, the year the crisis over Iraq reached its peak.

What explains the apparent paradox? Why have transatlantic foreign policy differences not slowed transatlantic trade and investment as many feared?

The first part of the answer is simply self-interest. Just as our political leaders did not let commercial disputes interfere with their pursuit of national interests during the Cold War, economic decision-makers are not inclined to allow political differences to interfere with their goals today. The bottom line remains that investors' main interest is return on capital – not the satisfaction of investing in firms whose parent nations' foreign policy is to their liking.

Similarly, consumers want quality products at good prices – they will not normally agree to pay more money for less desirable goods simply because those goods may (or may not) be produced in a country whose leaders they happen to agree with.

Certain businesses, no doubt, have to worry about political strains affecting sales, but evidence at the macroeconomic level is hard to find. As *The New York Times*

reported in May 2004, "American companies that sell globally say that they have so far experienced little if any disruption from discontent over the war in Iraq."

Another reason why business has so far been largely insulated from the political troubles is that the very concept of an "American" or "European" company is getting increasingly out of date.

Consider the degree to which some leading US-based firms are now integrated into the global economy. ExxonMobil, for example, holds 64% of its assets abroad, makes 70% of its sales overseas, and employs 61% of its workers outside the US. Is it an American company? Ford's numbers are 56%, 33% and 54%; IBM's 36%, 59% and 57%; McDonald's' 57%, 58% and 57%. Even 'all-American' Wal-Mart comes in at 32%, 16% and 21%.

Does it make sense to consider a company American when such a large share of its workers and customers are not?

The same is true for companies based in Europe. Britain's Vodafone holds 89% of its assets abroad, makes 79% of its sales overseas and employs 85% of its workers outside the UK. Is it British? For France Telecom, the numbers are 66%, 38%, and 42%; and for Germany's BMW, 65%, 75%, and 21%. How could US consumers and investors 'punish' a French company for France's opposition to the Iraq war when well over half of its employees do not even work in France?

A telling example of how corporate globalisation insulates trade and investment from international policies can be seen in the story of the French food-services company Sodexho Alliance, based in Paris.

Furious with France's opposition to the war in Iraq, and egged on by some calls in the US media for a boycott of French goods, members of Congress in March 2003 began calling on the Defense Department to cancel its $881 million contract with Sodexho to provide meals for US marines. But when the Pentagon – not known for reflexively siding with France – looked into the issue, cancelling the contract made little sense.

Sodexho, it turned out, employed 110,000 workers in the US, and $300 million of the Pentagon contract was going to small, disadvantaged and minority-owned US businesses that the Congressmen claimed they were trying to help. It had been chosen competitively based on the price and quality of its goods and services. And as Maryland Representative Chris Van Hollen pointed out, Americans were not the only ones with foreign policy complaints. "If the foreign governments who disagree with US policy toward Iraq should respond in a similar fashion by cancelling contracts with American companies, many more American jobs and companies would be at risk."

Prominent American companies seem equally insulated from political frictions. Even a firm as closely associated with the US as McDonald's is thriving in France, for example, where it plans to open 40 new outlets next year. The company is also doing well in Germany, whereas sales are sluggish in Britain, again raising questions about the correlation between overall political relations and economic choices. Two-thirds of McDonald's outlets in Germany are owned and operated by Germans, and most Germans seem to realise that German workers, not the US, would suffer most from a boycott – plus they seem to like the burgers and fries.

So is there really nothing to worry about? While the overall picture should be reassuring to firms on both sides of the Atlantic, no company can afford to be complacent. Even if politics only affect businesses on the margins, margins can be pretty important. The decision by a German bicycle manufacturer to protest the Iraq war by cancelling orders from America might not have had an impact on the overall trade figures, but that is probably small consolation for the US suppliers that lost the German contracts.

Specific sectors, moreover, can also suffer from the political strains more than the economy as a whole. A globalised French food and beverage company like Danone may do just fine in the US whatever Bush thinks of Chirac, but you can be certain that no major US defence contracts will be going to French firms when the two leaders are clashing over foreign policy. And French luxury goods like Moët & Chandon champagne or Dior scarves probably did not fare as well during 2003 as they would have in a different context.

European firms that benefit from America's $400-billion defence budget have a particular interest in avoiding foreign policy disputes. This explains why a company like British Aerospace is so concerned about the EU's plans to lift its arms embargo on China. It knows that such a move could prompt retaliation from the US Congress, halting technology transfer to European firms and cutting them out of the US defence market.

Even issues technically separated from foreign policy, such as the Boeing-Airbus dispute or differences on genetically modified foods, are more difficult to sort out when Americans' and Europeans' images of each other are so negative. And the failure to sort them out can prove costly when the result is economic sanctions or closed markets.

So yes, companies should worry about transatlantic political tensions and do what they can to promote understanding. A worsening political relationship will always be a dark cloud over the economic relationship, and a damaging storm can never be ruled out.

But the good news is that the transatlantic economy is now so integrated, and is so clearly in the interest of key players on both sides, that it can easily withstand a bit of rough weather. Given how positive transatlantic economic relations remained during the crisis over Iraq, one can only expect them to improve as the US and Europe pursue what seems, at least, to be a genuine if fragile reconciliation.

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