US-Europe tensions grow as Washington talks down the dollar

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The Bush administration's decision to encourage a decline in the US dollar signals a ratcheting up of transatlantic economic tensions. It threatens to return the world to the international economic climate that prevailed during the Great Depression of the 1930s, when rival monetary zones competitively devalued their currencies in order to boost their products' attractiveness on world markets.

Recent weeks have seen an acceleration of the downward movement of the dollar. The greenback has fallen roughly 40 percent since its high point against the euro in October 2000. On May 25 it reached 0.847 euros, a record low.

The dollar's slide vis-à-vis the Japanese yen—down 12 percent since January 2002—and the Chinese yuan has been more moderate, largely because both Asian countries have sold significant volumes of their own currencies in order to slow their rise relative to the dollar. Euro zone producers, whose exports have become more costly compared to those of both their US and their Asian rivals as a result of the relative rise in the value of the euro, have come under pressure from both the West and the East.

Following Treasury Secretary John Snow's comments indicating that the US government welcomed the decline of the dollar, sections of the US financial and business community welcomed the shift in policy. Interviewed by Reuters news service, New York-based Brown Brothers Harriman economist Lara Rhame said: "All the Treasury is looking for at this point is a controlled dollar decline. At the margin it's positive for the economy ... it's sort of a cost-free way for the administration to give small relief to manufacturers and exporters, and to help on price deflation."

The Bush administration has decided to increase US firms' market share at the expense of their international rivals. If the dollar continues to slide, the main effect will be to make US-made goods cheaper and more competitive on foreign markets. At the same time, it will allow American businesses to moderate profit pressures in the US by charging more for their goods, as the price of their foreign competitors' products rise.

The measures have symmetrical but opposite effects on Europe. First, European firms will lose market share. Second, price levels in Europe, which is already concerned about deflation, will tend to fall as US goods become cheaper and European firms try to cut prices to compete. This takes place under conditions where the German, Italian, and Dutch economies contracted slightly during the first quarter of the year, and French economic growth was negligible.

So far, European financial authorities have tried to downplay the stress the falling dollar is placing on the European economy. The head of the European Central Bank (ECB), Wim Duisenberg, has maintained that a strong euro is good for the euro-zone economy. Gertrude Tumpel-Gugerell, vice-governor of the Austrian central bank and future member of the ECB governing committee, stated on May 26 that the euro's current levels are "bearable."

However, European governmental and business circles are increasingly concerned. On May 9, French Prime Minister Jean-Pierre Raffarin stated his support for a European interest rate cut to close the euro-dollar gap, adding: "I think it's troubling that we are today at levels where our exterior trade would be penalized should this gap between the euro and the dollar persist."

On May 15, German Finance Minister Hans Eichel said that the strong euro gave the ECB the opportunity to cut interest rates, which would tend to drive the value of the euro down. European interest rates, although historically low at 2.5 percent, are higher than the extraordinarily depressed interest rates in the US (1.3 percent).

French Economy Minister Francis Mer said that the situation would be dangerous if the euro traded at between $1.20 and $1.25, but maintained "at [a] level of $1.10 or $1.13, the situation is still manageable." This is cold comfort, since economic analysts are revising expectations as to where dollar-euro exchange rates will go.

Japanese economist Eisuke Sakakibara has forecast that the euro will trade at between $1.20 and $1.30 in 2003, while C. Fred Bergsten, director of the Institute for International Economics in Washington, DC, predicted a possible range of $1.27 to $1.32. The *New York Times* noted that this would bring the dollar "within striking distance" of the dollar's post-1973 low against the German currency, which translates to an exchange rate of $1.45 per euro.

The effect on euro-zone businesses and markets has quickly made itself felt. Several days of falling prices on the German and French stock markets have been attributed to the euro's strength. In addition to cutting demand for European goods, lower dollar-euro exchange rates are hurting European firms with a significant presence in the US, as their dollar-denominated earnings now reap smaller rewards when translated into euros.

These profit pressures are hitting major German and French firms such as Bayer, BASF, Siemens, DaimlerChrysler, Volkswagen, Airbus/EADS, TotalFinaElf, Alcatel, and Michelin. At a meeting of the Italian employers' federation Confindustria, attended by Italian Prime Minister Silvio Berlusconi, keynote speaker Antonio d'Amato attacked the ECB for not taking more aggressive measures to halt the dollar's slide against the euro.

The ECB seems increasingly likely to give in to pressure to cut interest rates to halt the rise of the euro against the dollar. Already on May 8 Ernst Welteke, president of the German Bundesbank, said that the dollar's sudden rise presents a long-term risk to German competitiveness. On May 23, the directors of the central banks of Spain and the Netherlands, Jaime Caruana and Nout Wellink, made statements suggesting support for a fall in interest rates.

A decision by the ECB to lower interest rates would not, however, guarantee a more stable economic situation. First, there is no guarantee that an ECB rate cut would halt the slide of the dollar, which stems not only from differences in interest rates between the EU and the US, but also from gigantic US trade deficits and massive deficit spending by the Bush administration. Second, under conditions where the Bush administration and powerful segments of the US business elite have welcomed the fall of the dollar, attempts by the ECB to lower the euro's value against the dollar might trigger renewed attempts by US authorities to bring down the dollar. A return to 1930s-style competitive devaluation policies would then be directly posed.

Such decisions would immensely aggravate existing economic and political differences between the US and European Union (EU) governments. Trade disputes between the US and the EU, which have been numerous over the past few years, have already intensified in recent weeks.

On May 7, the World Trade Organization (WTO) granted the EU the right to impose $4 billion in punitive tariffs against US products, as Washington failed to comply with a WTO ruling against a tax break for US-based multinational corporations. It was the largest sum ever granted in punitive sanctions by the WTO. EU Trade Commissioner Pascal Lamy warned that the EU would not immediately exercise its right to impose the tariffs, but that it would do so if the US Congress failed to repeal the tax law by the beginning of 2004.

On May 13, the Bush administration retaliated by deciding to press a complaint at the WTO over the EU's ban on genetically modified food. A successful fight against the ban will have ramifications not only in Europe, where the ban enjoys considerable popular support, but also in international diplomatic relations. The Bush administration has blamed African countries' refusal to accept US genetically modified food aid on the example set by the EU's "immoral" policy.

The most destabilizing influence on transatlantic relations, however, is unquestionably the Bush administration's decision to occupy Iraq and politically isolate those European powers that in some way opposed the war.

Up to now, US reprisals against other major powers have taken the form of diplomatic snubbing—refusing to congratulate German Chancellor Gerhard Schröder for his election victory on an anti-war platform, circumventing France in NATO decision-making, etc.—and a viciously xenophobic, especially anti-French, campaign in the US press. However, commercial and political motivations militated against more obvious attempts at economic reprisals, such as boycotting German or French companies' products.

The fall of the dollar is not simply the result of a political calculation by the Bush administration. Rather, it is the inevitable consequence of the debt-ridden nature of the US economy and, in particular, the tax and fiscal policies of the Bush administration. There is little doubt, however, that in their current hysterically anti-European mindset, significant sections of the Republican Party welcome a measure that economically hurts those countries whose governments opposed the Bush administration's rape of Iraq.

The European bourgeoisie has taken note of the political considerations involved in the fall of the dollar. In a May 10 editorial, the leading French daily *Le Monde* wrote: "Maybe we no longer have to ask how the White House will economically retaliate to make the two main euro-zone powers, Germany and France, pay for their opposition to the Iraq war. Considering the euro's current takeoff against the dollar, the reprisals have already begun."

The political significance of the Bush administration's policy of a weak dollar is that it links the growing commercial and industrial antagonisms between the EU and the US with the political and military antagonisms that have been stirred to new heights by the Bush administration's war in Iraq. It does so as developments—from the recession and financial instability on both sides of the Atlantic to the Bush administration's belligerent moves against Syria and Iran—promise to further heighten transatlantic tensions.