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The United States and the European Union are very politically and economically integrated. Their trade and monetary policies affect the rest of the world dramatically but because they are so integrated, their policies have a huge impact on each other as well. With the growing strength of the EU, it is no longer a one-way relationship where "If the US sneezes, the world catches a cold" (common saying), it is no longer only the US affecting and dominating the world economic spectrum. The EU's growing economic strength also makes it a powerful player in the world economy. However, the EU's strength does not solely derive from a particularly productive economy, if this were the case, this paper would research the effects of the growing Chinese economy on the US. Along with the fact that it one of the US's largest trading partners, the EU's protectionist tendencies along with its strong economic and monetary integration, makes it a large, powerful player in the world economy, such that it has the power to affect the US economy like no other single entity.

The EU has been continually working on its integration. The efforts of integration between EU member countries include political and economic norms and policies that are intended to facilitate trade and stability within the EU. However, these integration efforts give little consideration to the economic implications on countries outside of the EU. As the EU's largest trading partner, the US-EU economic relationship has been heavily affected by some of these economic policies, specifically, the emergence of the euro as a major competing economic currency. At the onset of further EU integration policies, analysts discussed the future of the US-EU economic relationship. Some predicted that the integration would lead to a more prosperous economic relationship between the EU and the US. However, others predicted that the EU's increasing integration would place a barrier between EU-US economic relations.

One major development in the EU economic integration has been the emergence of the euro as the EU's newest monetary system. Although the euro facilitates transactions allowing for the use of a single exchange rate, the monetary system carries with it other problems that further create a wall between the US and the EU's economic relationship. The euro has shown signs that it may face-off the US dollar as a future potential world reserve

currency. The strength of the euro might ultimately cause the US to see the EU not as a partner but a rival in world politics and economics.

Talks about integrating the EU with one single monetary system date back to its very beginning in the 1950s when it was still known as the European Coal and Steel Community. However, it was the economic crisis of the 1970s that triggered more serious efforts to unite the EU under one single monetary system (Europa). The 1973 Oil Crisis resulted from the Organization of Arab Petroleum Exporting Countries' (OAPEC) decision to no longer export oil to nations that had supported Israel during its conflict with Syria and Egypt and of the Organization of Petroleum Exporting Countries' (OPEC) decision to use their leverage to raise the world price of oil after failed negotiations with the major oil and distribution companies which are owned by industrialized nations. Because of the high demand of oil that industrialized countries, especially the U.S. have, the OPEC was able to trigger a large economic crisis that heavily affected the US, the largest oil consumer in the world. As a result, the economies of European countries that at the time pegged their monetary systems to the U.S. dollar were also affected (Antweiler).

After the problems of having their currencies so interlaced with the US became evident, EU countries began negotiations to adopt a new currency system. The European Monetary System was established in 1979 with the objectives to "stabilize exchange rates, to reduce inflation and to prepare for European monetary unification (EuroLocal)". This marked the end of European currencies' direct dependence on the US dollar. The European Monetary System and years of negotiations eventually gave way to the creation of the euro, the EU's single legal currency. On January 1, 1999 the system emerged in financial institutions. On Jan 1, 2002 twelve countries, (Belgium, Germany, Greece, Spain, France, Ireland, Italy, Luxembourg, The Netherlands, Austria, Portugal, and Finland) went beyond that by adopting the euro as their monetary currency. As of today, the "eurozone", the area of the EU where the euro as a monetary system has been adopted includes fifteen countries: Austria, Belgium, Cyprus, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, Netherlands, Portugal, Slovania and Spain (BBC). The euro has created a unique internal dynamic within the EU as it now acts as one single nation in many respects, setting interests rates in unison. The shared monetary system facilitates trade and other economic transactions within the EU and grants the participating countries a currency that is much more stable than the countries' previous currencies and not so directly affected by US dollar fluctuation.

Although the emergence of the Euro has facilitated trade and has proven to be strong enough to compete with the US dollar, the monetary integration of the EU is not yet complete. Many EU countries have not yet adopted the euro as their monetary currency. Denmark and the U.K. are not legally required to enter the eurozone, they gained the exemption during the Maastricht Treaty of 1992, which created the EU and set the criteria that countries need to meet in order to enter the Eurozone. Sweden has used the criteria loophole to avoid entering the Eurozone. The criteria include qualifications in respect to price stability, fiscal prudence, EMS membership and interest-rate convergence (gocurrency). However, most other EU nations are in the process of meeting the criteria and soon joining the Eurozone.

At the beginning of the 21st century, the US economy was experiencing what National Bureau of Economic Research (NBER) described as a recession. In March 2000 the NASDAQ crashed due to the burst of "Dot-com bubble" and so was the case following

the terrorist attacks of September 11, 2001. Further economic troubles can be attributed to the wars in Iraq and Afghanistan, the large increase of oil prices and the slow economic growth; all which have contributed to a decreased international faith in the US. The US government has taken several measures to fix these problems such as lowering interest rates in order to promote investment. However, close analysis of the recovery that economists say began in November 2001 suggests that it is possible that the US economy might end up suffering yet a third recession. Since March 2001 the employment rate has only gone up by 1.9% while inflation-adjusted wages are lower today than they were at the beginning of the recovery. Also, the household income of the middle class has been falling for the past five years. The result of these problems has been a rise in inflation, a housing and financial crisis and negative consumer spending (Richebächer).

On the other hand, the emergence of the Euro as the legal currency of EU nations in 1999 has had strong positive effects on the economic stability of the EU. The EU's unemployment rate since 2000 has averaged 7.4 percent, and it has considerably decreased from 8.6 in 2000 to 7.1 in 2007. The decrease in unemployment rate can be seen even more dramatically if we look only at the 15 European states that have adopted the Euro as of today (EU-15). Their unemployment rates average at 7.7 percent, and go from 7.7 in 2000 to 7.0 in 2007 (U.S. Dept. of Labor). All of this makes the euro a very appealing currency for the rest of the world, displacing the US dollar in the minds of people who begin to prefer carrying out a transaction in Euros than in the depreciated dollar.

The US has been experiencing a weakened currency of recent years. One implication of having a weak currency is that exports become cheaper, which should be a reason for the demand for them to increase. However, this does not occur when there exists trade barriers against the products that are being exported. In this case, although the US possesses a comparative advantage in the production of agricultural goods and services, the EU has put in place several obstacles that impede US access to the EU market for its goods. Ceteris paribus, the EU experiences the contrary in terms of its exports to the US. This puzzling situation carries within it the seeds of much disagreement and debate, as if the Great Depression did not teach the world anything.

During the Great Depression, US protectionist policies worsened the depression by placing trade barriers that prevented much foreign trade to enter the US market. By doing so, the US slowed the flow of money that could've boosted world economy and lessened the effects of the Great Depression. From that experience it was learned that free trade is the better choice, that although governments' initial impulse could be to protect its own economy and not allow for its currency to leave the country, what actually should be done is push the flow of money through the promotion of trade. By allowing foreign nations to sell their products in the home country, in turn these foreign nations will have a more stable economy that would afford to buy home products. However, despite the Great Depression's lesson of free trade, some nations appear to have forgotten the potentially catastrophic effects that protectionism and an overwhelmingly strong monetary currency could have on the world economy.

The United States and the European Union are highly interdependent economies. They are the two largest economies in the world, together accounting for more than two fifths of world trade. The US is the EU's largest non-EU trading partner, and the EU is one of the US's largest trading partners, second only to Canada. "In 2004, the EU accounted for 21.1 percent of total U.S. exports and for 19.2 percent of total U.S. imports" (Cooper, CRS

Report for Congress). However, this trade relationship has been under a lot of stress for the past decades as a result of the tensions created by the establishment of the CAP (Common Agricultural Policy) in 1962 which acts a direct but uncompetitive competitor of the US regarding agricultural production; thereby placing a block in the amount of goods that can enter the EU fortress.

This conflict is counterintuitive for it goes against one of the pillars of the western world, something that both the US and the EU regularly promote: free trade. In technical terms, if the US's cheaper agricultural products were allowed to enter the EU this would allow the EU to spend the money destined as farm subsidies through the CAP in other industries. However, because this is not the case, a lot of money is being misallocated rather than aiding the further growth of the economy. As the EU continues to consolidate its powers through the integration of its member states' economies, polemics over issues such as agriculture arise due to the nature of the decision-making process of the organization. In this case, the euro itself is not to blame for the dispute over agriculture. The euro however can be seen as binding tool used by countries like France to impede any sort of progress that could be established toward the resolution of this debate. The EU could lend a hand to the US by decreasing its regulations on US agricultural imports and thereby reducing its economic deficit and diminishing the effects of its current economic recession. But due to national interests, conventional economic thinking is thrown out of the window by using tools, in this case the EU as an organization and its components that make it possible such as the euro, that have the liberal ideology as it driving mechanism but, fail to regularly promote them outside its own bubble.

There is however a direct consequence that results from the depreciation of the US dollar against the euro. Due to the competitive nature of nations in the international spectrum, the US and the EU fiercely compete for the primary goods needed to fuel their respective economies. In this particular case the most relevant primary good is oil. Since the US and the EU are technically competing against each other, the purchasing power of their currency is extremely important. The reason lays on the fact that exchange rates vary depending on several economic indicators (mentioned above) that determine the supply and demand of the given currency. The US dollar has depreciated because currently its economy is going through a deep turmoil. Therefore, it is expected that supplying countries of primary goods might tend to sell more of its products to the party that offers the most money for them, or one with a stronger currency. For this reason, the relative strength of the Euro, in comparison to the depreciated dollar has cushioned the cost of commodities for the EU-15. For instance, oil prices in the EU are seemingly less affected than in the U.S. If, for instance, the Europeans can buy a barrel of oil at 66 Euros, Americans must pay over 100 dollars for it. This is the case in the EU for most imports, thereby contributing to the increasing trade deficit that the U.S. is running each year. As the EU spends less and less on imports and in relative terms US exports are devalued, the trade deficit of the US keeps rising. Nonetheless, the trade deficit that the US runs might be seen as beneficial for the rest of the world since the US economy is in fact driven by consumer spending. Thus, a very interesting question arises: what would be the impact of the euro if it took the place of the US dollar as the primary currency for global transactions?

About two thirds of world trade is currently being conducted in dollars and two thirds of central banks' currency reserves are held in US dollars. The US dollar is still also the only currency being used by international institutions like the IMF. This creates a huge demand

for the American currency, which gives the US the privilege to be able to run a huge trade deficit every year. In fact, it is encouraged to run such deficit in order to keep catastrophes such as the Great Depression for occurring again. By running this deficit, the US is feeding the world money supply and thereby allowing countries to be able to repay their debt to the IMF as well as purchase products from other countries, stimulating trade and the worldwide flow of money. Essentially, the US's huge spending aids the economic development of the countries that hold the American dollar as their reserve currency as well as countries that are willing to spend money and not just save it within their borders. By running this economic deficit each year to such extent that the US imports 50% more goods and services than it exports, it is feeding the world economy at the expense of its growing debt. The US has been able to maintain itself in a relatively stable economic status despite its increasing trade deficit and its huge defense spending. Additionally, the US has been able to maintain some of the lowest taxes of any industrialized country, all because it has remained the dominant international currency and thereby the demand for the US dollar has remained very high.

The EU has used towards its advantage the US's willingness to run a huge trade deficit. The US has been feeding the EU economy and thus allowing it to develop a strong economy and build a strong currency. All the while, the US has run up its trade deficit each year, the euro has had the great opportunity to develop to the point that it is about to become a major threat to the US dollar. In fact the Euro is at a level that it is now being looked at by other countries as a potential reserve currency itself.

If the euro were used as a reserve currency in place of the dollar, this would have major economic implications not only for the US, but also for the world economy. Even the EU would come out losing from an abrupt shift from the US dollar to the euro. For the US, if the demand for the US dollar as a reserve currency were to decrease, it would no longer be able to sustain its ongoing trade deficit, it would have to shift from being a primary importer of goods and services to being a primary exporter of goods and services. With the US's need to sell its goods and decreased demand for imports due to its bad economic situation the world would be losing a very large market. The US's purchasing power has stimulated the world economy for many years, a shift to the euro as a reserve currency would greatly decrease US purchasing power and devastate the economies of many countries who depend on the US for a market to their goods.

Even if we assume that the euro could successfully emerge as a reserve currency, and that the US were left to deal on its own with all of the implications that would result from a decreased demand for the dollar, some other entity would have to arise to make up for the lost purchasing power that the economic demise of the US would provoke. Another nation, perhaps China, or several entities would have to take on the role of world consumer, at minimum, increase the amount of imports considerably, perhaps also running a trade deficit as the US has done, in order to prevent a world economic collapse. The EU would not be able to emerge as that major purchaser because what has stimulated its economy all of these years has been its trade relationship with the US. The EU heavily depends on the US market as a stimulus for its economy. If the US can no longer purchase EU products to the extent that it has, the EU economy would be in trouble and as a result the economies of the countries that shifted their reserve currency to the euro. Ultimately, a shift to the euro as a reserve currency in place of the dollar would be catastrophic unless several other measures were taken in order to prevent a major economic demise.

US influence in the world is linked to the strength of its economy. A strong US dollar represents a stronger inclination to adhere to US policies. A high exchange rate of the US dollar leads to higher demand for the dollar and willingness of other countries to sell their goods in the US in exchange for the strong stable currency; a currency that has represented stability and high returns to the point of being held as the world's reserve currency. However, the weakening of the US dollar in recent years has given way for a new currency, a new monetary system to emerge as the potential new currency of the world. The euro, which emerged in 1999 has strategically taken advantage of the role of the US as the primary purchaser of the world and has gained much strength. With its weakening dollar, US influence is also suffering. Nonetheless, the Euro's strength depends on the strength of the US economy for the EU is highly dependant on the US consumerism. Recently, the US was able to appreciate against the euro due to the expectation that a US recession might in fact cause a EU recession. Therefore, even though it is not clear what the future holds for both the US and EU, it is clear that a direct confrontation between both currencies will cause a global economic downturn and great suffering in each other's economies. For this reason it is imperative that both the US and EU engage in talks that might prevent a future catastrophe.

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