The Transatlantic Economy: Current Trends & Prospects

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It is clear that the strength of the economic relationship between the EU and the US has the potential to outweigh most transatlantic tensions. This is because the combined economies of the EU and US account for nearly 45% of global GDP, 23% of world trade in goods and 30% of world trade in services.

Trade

The EU and the US are both among the largest players in global trade. In 2007, the total trade volume for the EU was $3.642 trillion dollars, while the US accounted for $3.116 trillion dollars. These two countries represent the two largest traders in the world.

Further, the EU and the US are each other’s main trading partners and account for the largest bilateral trade relationship in the world. The EU and the US both account for nearly one-fifth of each other's bilateral trade (which includes trade of goods and services), or what amounts to over €1.7 billion ($2.2 billion) per day. In 2008, exports of EU goods to the US amounted to € 249.6 billion (19.1% of total EU exports), while imports from the US amounted to €186.4 billion (12.0% of total EU imports).

However, with the recent economic crisis, the value of the trade relationship has cut. In the first half of 2009, the value of EU exports to the US fell to 101 billion compared with 127 billion in the first half of 2008, and imports decreased to 85 billion from 94 billion (Graph 1).

Graph 1: EU trade in goods with US

million euro		2001	2002	2003	2004	2005	2006	2007	2008
US	**Exports**	245 594	247 934	227 282	235 499	252 683	269 005	261 484	250 091
	Imports	203 298	182 618	158 124	159 374	163 511	175 223	181 594	186 810
EU	**Exports**	884 707	891 899	869 237	952 955	1 052 720	1 159 324	1 241 498	1 306 611
	Imports	979 143	936 967	935 265	1 027 522	1 179 569	1 351 813	1 434 010	1 566 117

Eurostat, October 30, 2009

Most of the traded goods between the EU and US are manufactured products; over 80% of EU exports to the US and 83.3% of EU imports from the US were manufactured. These manufactured goods include, in descending order, machinery, chemicals, and transport equipment (including automobiles) were the largest items of trade in both directions.

In terms of the services trade, the EU exported 136 billion euro of services to the US, while imports amounted to 132 billion in 2008 (Graph 2). Speaking relatively, this number is considerably low, when the amount of service industries that operate transatlantically is accounted.

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Graph 2: EU trade in services with US

million euro	Credit			Debit		
	2006	2007	2008*	2006	2007	2008
Total	**133 753**	**139 135**	**136 048**	**122 029**	**127 718**	**132 248**
Total EU	**447 080**	**498 523**	**520 479**	**378 555**	**414 399**	**445 044**
US/ total EU	**29.9%**	**27.9%**	**26.1%**	**32.2%**	**30.8%**	**29.7%**

Eurostat, October 30, 2009

Investment

The investment links are even more substantial. In 2007, investment from the EU to the US was €113 billion, while investment from the US to the EU was €145 billion. The share of EU investment in the US amounted to more than 50% of EU foreign direct investment, while US investment in the EU was more than 61% of EU FDI inflows. Indeed, nearly 60% of global foreign direct investment occurs between the EU and the US.

Figure 1. U.S. Direct Investment Abroad

in millions of dollars, on a historical-cost basis, 1990 to 2003

[U.S. investment abroad is defined here as the ownership or control by one U.S. person of 10% or more of the voting securities of an incorporated foreign business enterprise or an equivalent interest in an unincorporated foreign business enterprise. A negative position can occur when a U.S. parent company's liabilities to the foreign affiliate are greater than its equity in and loans to the foreign affiliate]

Country	1990	1995	1998	1999	2000	2001	2002	2003
All countries	430,521	699,015	1,000,703	1,215,960	1,316,247	1,460,352	1,601,414	1,788,911
Europe	214,739	344,596	518,433	627,754	687,320	771,936	848,599	963,087
Canada	69,508	83,498	98,200	119,590	132,472	152,601	170,169	192,409
Latin America and other Western Hemisphere	71,413	131,377	196,755	253,928	266,576	279,611	284,561	304,023
Africa	3,650	6,017	14,061	13,118	11,891	15,574	16,290	18,960
Middle East	3,959	7,198	10,739	10,950	10,863	13,212	14,671	16,942
Asia and Pacific	64,716	122,712	159,678	190,621	207,125	227,418	267,125	293,490

Source: U.S. Bureau of Economic Analysis, Survey of Current Business, July 2003, and earlier issues.
See also http://www.bea.doc.gov/bea/ARTICLES/2004/07July/0704DirectInvest.pdf> (released July 2004).

From 2000-2008, Europe accounted for over 57% of total US FDI. US investment in the BRICs (Brazil, Russia, India, and China) totaled $57.6 billion from 2000-2008; this amount, which is equivalent to US investment in Germany, is roughly 14% of total US investment in all of Europe. In 2007, US investment in Europe was 16 times larger than in the BRICs and 3 times more than all of Asia. Comparatively, EU investment in the US during 2007 was 12 times the level of investment in China and 28 times the level of investment in India.

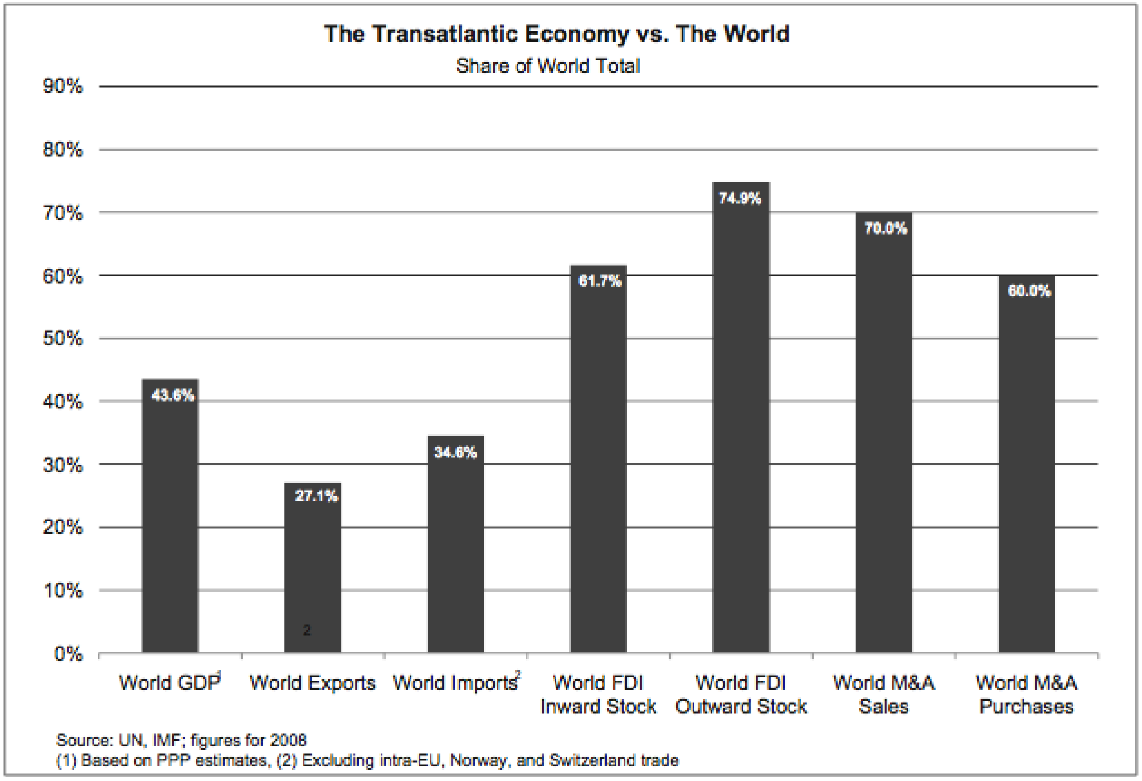
Graph 3: EU FDI flows with USA

(million euro)	**2005**	**2006**	**2007**	**2008***
EU FDI in the US (outward)	36 525	108 033	145 560	149 243
US FDI in the EU (inward)	67 153	76 724	180 037	44 646

Eurostat, October 30, 2009

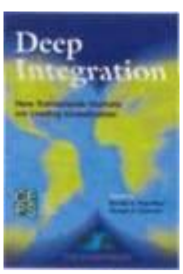
Knowledge

The transatlantic knowledge relationship is also telling. Transatlantic knowledge, the idea of knowledge being shared by actors (states, organizations, companies, etc.) across the Atlantic, is best represented by research and development expenditures. In recent years, US companies have spent $18.6 billion on R&D in Europe, nearly 65% of total R&D expenditures.



Hamilton and Quinlan, "The Transatlantic Economy 2010: Annual Survey of Jobs, Trade, and Investment between the United States and Europe"

Potential and Benefits of Additional Transatlantic Integration



The economies on both sides of the Atlantic are working together in an effective fashion that is generating further trade, increasing jobs, and encouraging economic growth. Nevertheless, as Daniel Hamilton and David Quinlan argue in "Deep Integration: How Transatlantic Markets Are Leading Globalization", transatlantic economic integration still has enormous additional potential. Greater benefits can be achieved, with the OECD indicating that "further transatlantic liberalization could lead to permanent gains in GDP per capita on both sides of the Atlantic."

Trade liberalization of services, often called the sleeping giant of US-EU economic relations, is another way to improve the transatlantic economies. Liberalization of the trade of services is often associated with legal and political problems as services are heavily regulated, especially in the EU. Because of this, little has been done in this area. Currently, the service sector accounts for the bulk of job creation in both the EU and US. Further liberalization of trade in services could result in a sharp increase of employment levels and economic growth. Hamilton and

Quinlan, among other scholars, have echoed this point: "Following in the footsteps of manufacturers, US and European service companies now deliver their services more through foreign affiliate sales than through trade. In the 1970s and 1980s, firms delivered services primarily via trade. In the 1990s, foreign affiliate sales became the chief mode of delivery. Sales of services by US foreign affiliates in Europe soared from $85 billion in 1994 to roughly $212 billion in 2002 - a 150% increase, well ahead of the roughly 65% rise in US service exports to Europe over the same period. US foreign affiliate sales of services in Europe - after being roughly equal to US service exports to Europe in 1992 - were nearly double the value of US service exports in 2002."

Undoubtedly, a pointed expansion of the transatlantic trade of services to a point comparable to the rates of investment is unlikely in the near future. This process will surely face similar problems as another organization working on liberalizing the trade of services, the WTO. The staunch opposition to the WTO has resulted in a limited amount of services to be ‘liberalized.’

Nevertheless, efforts for transatlantic cooperation continue. In April 2007, European Commission President Jose Manuel Barroso, German Chancellor Angela Merkel and US President George W. Bush signed the "Framework for Advancing Transatlantic Economic Integration between the USA and the EU". This framework, among other things, established the Transatlantic Economic Council (TEC), which oversees and promotes the implementation of work designed to closer integrate the EU and US economies. The TEC brings together members of the European Commission and members of the US Cabinet, people who hold the political responsibility to foster closer economic ties. The signing of this framework signaled the need for transatlantic harmony, increased cooperation, better products, and less overall regulatory burden.

Additionally, other EU-US forums have been agreed upon: the Transatlantic Legislators' Dialogue, Transatlantic Consumer Dialogue, and the Transatlantic Business Dialogue.

Immediate Impact? Coordination and Management of Non-Tariff Barriers
Harmonizing technical and safety standards between the EU and the US could result in (near) immediate and tangible benefits. Non-tariff barriers, as opposed to tariff barriers, are still the most relevant impediment to the expansion of transatlantic trade. Transatlantic tariffs are generally low, averaging between 3-4% of the €500 billion in annual transatlantic trade. Indeed, tariffs have been generally low for the past three decades.

Differences in technical and food safety standards represent a stumbling stone in the further integration of US-EU economies. This issue is covered, albeit partially, by WTO agreements, such as the technical barriers to trade (TBT) agreement. However, these agreements do not represent completion or totality of work towards the end of non-tariff barriers.

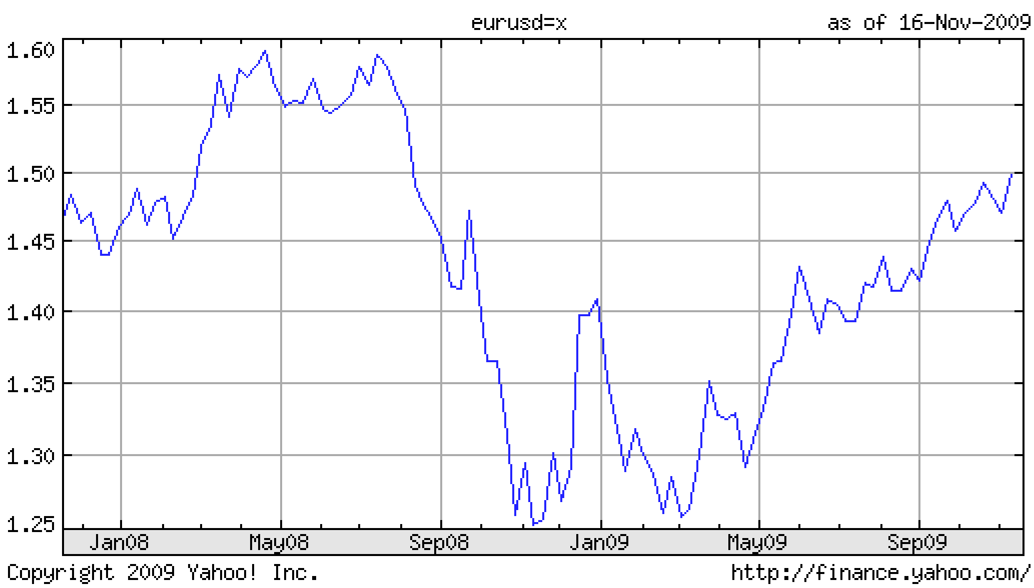
Many important trade disputes under the WTO settlement system, including the agreement on genetically modified organisms (GMOs), are directly related to non-tariff-barriers. Harmonization or at least coordination of technical and safety standards could not only improve transatlantic trade, but also bring about additional institutional integration.

However, many have critiqued the idea of the reduction of nontariff barriers; creating these institutional changes could be unnecessary at best, and deleterious to the economy at worst. Hamilton and Quinlan, among many others, indicate that institutionalizing changes to tariffs barriers could result in deleterious effects to the economy. Critics argue that transatlantic trade is a firm-to-firm relationship. Foreign investment accounts for the bulk of transatlantic commerce, rather than trade in goods, which represents less than 20% of US-EU commerce. Institutional changes, especially the expansion of the institutional framework, would be not only unnecessary, but also potentially harmful.

This does not mean a federalist or functionalist goal is out of the picture. In particular, the harmonization of technical and safety standards would require an institution that would oversee the implementation of the agreement. A step toward standards-setting could thus signify a first move toward a more permanent transatlantic forum dealing with economic integration.

Exchange Rates: Building a G-2

Progress in transatlantic integration requires a solid monetary foundation. By affecting the relative price of goods and services, the exchange rate influences international trade; excessive changes in it can be disruptive to efficiency and continuity of work. As a matter of fact, the need for continued efficiency of the EU's internal market trade was the primary motivation behind the institution of the euro. The instability of the euro-dollar exchange rates depresses the progress of the common US-EU economy. Continued instability might adversely affect the existing level of common economy.



With this in mind, the Peterson Institute for International Economics, in its study *The Euro at Five: Ready for a Global Role*, made a case for the formation of a G-2 monetary regime, with an informal steering committee. The authors point out that the current set of G-7 meetings is inadequate to serve the above purpose and that a deeper and more stable cooperation is required.

The authors consider how such an agreement may prompt further transatlantic cooperation. Central banks would be charged with managing the exchange rate agreement, which would stabilize the relationship between the Fed and the ECB. However, closer US-EU cooperation in monetary policy would require a consolidation of the decision making process in Europe, in particular in the field of fiscal policy, which is still subject to the unanimity rule.

The authors seem to follow the logic of spillover. That is, the institutionalization of an agreement on fixed euro dollar exchange rate would boost further political cooperation. In fact, the adoption of a controlled exchange rate regime, even with a very broad fluctuation range, implies a need for significant macroeconomic coordination on both sides of the Atlantic.

This proposal is particularly important; the current financial and economic crises and the recent instability of a dollar unveiled the shortcomings of the current international monetary system. Many economists, including Martin Wolf in many of his articles, have called for the reintroduction of a managed monetary system, like an updated Bretton Woods. The US and the EU may thus act as pioneers with the possibility of expanding a managed US-EU exchange rate mechanism to other countries.

The drawbacks of this proposal are related to the debate about fixed-flexible exchange rates. A fixed exchange rate has serious flaws as well as benefits. Past experiences like Bretton Woods itself have shown how difficult is to coordinate a system of pegged currencies. However, the level of transatlantic economic integration is far higher than in the past, as is the degree of integration of European economy. A flexible exchange rate system will avoid the difficulties of a fixed exchange rate. A joint US-EU exchange rate system, flexibly harmonized rather than strictly pegged, is needed and is likely to be successful. (More information can be found in the Transatlantic Monetary Integration section).

Emerging Storm? The Impact of US Debt on Transatlantic Integration
The US external deficit is the subject of an increasingly heated academic debate. It seems counterintuitive that the US, the largest and most powerful economy in the world, is also the largest debtor in the world. In 2008, the US held net liabilities of $8.1 trillion, or 56 percent of GDP. The current account (goods, services, transfers, and capital income) is massively in deficit-about $706 billion in 2008, or about 5 percent of GDP. This number has increased dramatically (and will increase in the coming years) with the recent government assistance in the economy.

However, most economists do agree that deficits are not necessarily deleterious to the health of an economy. Trade deficits, as paradoxical as it sounds, actually can be a good indicator of the economic well-being of a country. However, problems can arise when external deficits finance domestic consumption, at both a private and a public level. In this case, the external imbalances might turn unsustainable in the long term, as the economy is not capable of producing the income necessary to pay off foreign borrowing.

It is of note that adjusting US imbalances may result in higher consumption in Europe. The belief that Europe, China, and Japan should rely more on internal growth than on exports is not a new idea and this idea was given considerable attention at the recent G-20 Summit. In a transatlantic perspective, this may be perceived as an incentive for US to increase exports to Europe. At a time when US consumption has collapsed, exports are helping the US economy stay afloat. A new, more sustainable transatlantic economy would have Europe boosting domestic consumption and the US expanding its exports as share of GDP.

Additionally troubling is that US liabilities are owned by many foreign governments and as of recent, are being bought at a very high rate. Foreign governments now own over 25% of the national debt (through Treasury securities), up from 13% in 1988. Of the total Treasury securities owned by foreign governments, China owns 23%, Japan owns 21%, and the United Kingdom owns 7%; a host of other nations own the remaining 49%. Treasury securities, which are a way to generate income for programs and to pay off debts, are becoming increasingly tricky as the US government now owes, and will owe, money to foreign governments who have purchased Treasury securities.

It still remains to be seen whether US foreign liabilities will actually pose a serious problem for the transatlantic economy (and global economy, for that matter). While there are many differing opinions, it is quite clear that some form of adjustment of the US deficit, particularly in terms of exchange rate, has to occur. This adjustment has significant implications for the US-Europe alliance.

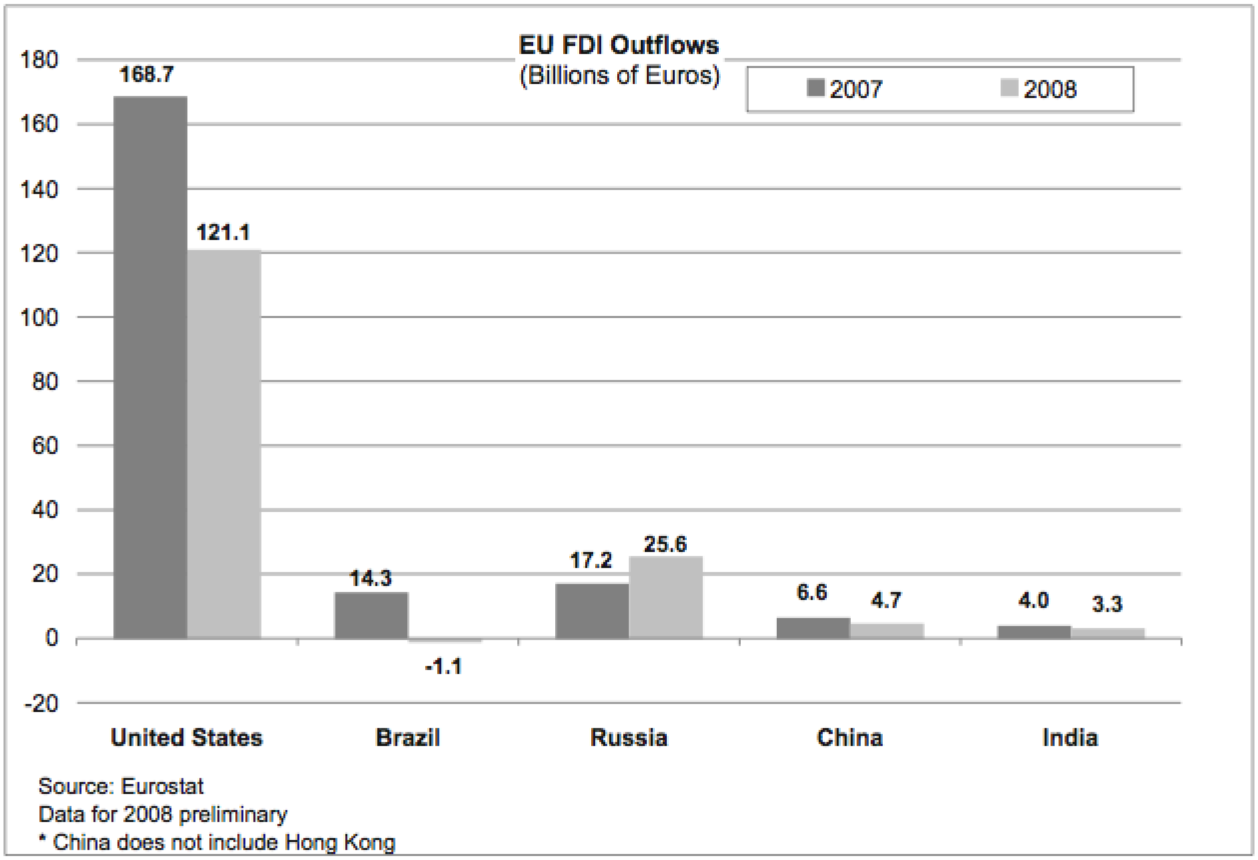
Conclusion

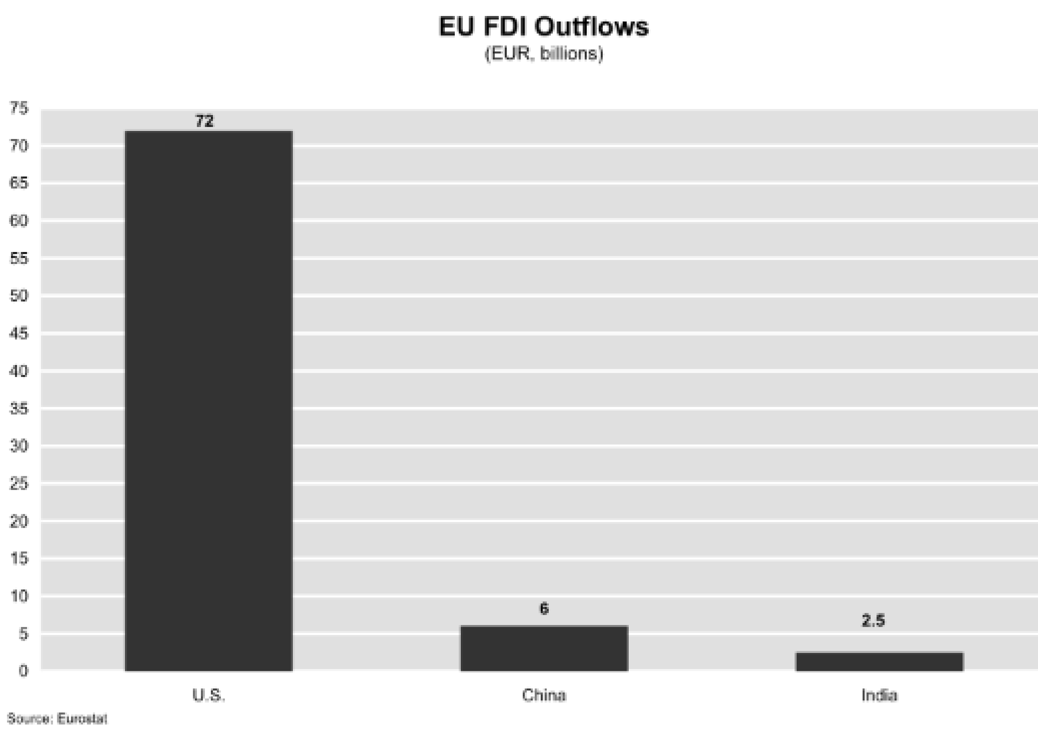
The above information and data strongly suggests that the EU and US economies are interdependent to a very high degree; that is, the total trade and investment flow between the EU and the US amounts to about €2.7 trillion ($3.4 trillion) per day, which supports approximately 14 million jobs on both sides of the Atlantic Ocean.

Recently, however, both sides have struggled to efficiently develop stronger economic ties. It is important to understand that the transatlantic economies can wield more clout, which will result in greater trade volume, larger investment, increased job creation, and ultimately, high economic growth rates, if, and only if, a unified and integrated transatlantic approach is utilized. The work of the TEC and other organizations targets the unified transatlantic approach, but more must be done.

Improving the economic relationship should come in three major, all of which will harmonize relations: 1) All regulations, non-tariff barriers, and other procedures, all of which have led to an impasse in the transatlantic relationship, must be removed; 2) The EU and US economies could focus their energies on issues relevant to both: climate change, economic growth, security, etc. This will encourage greater interconnectedness; 3) If the transatlantic economic relationship is to succeed, it is necessary for all countries involved to tackle their own domestic economic issues to rectify any consumer confidence issues.

Once these measures are taken, actors that participate in the transatlantic economy will reap the benefits from a stronger and better connected partnership with the other.





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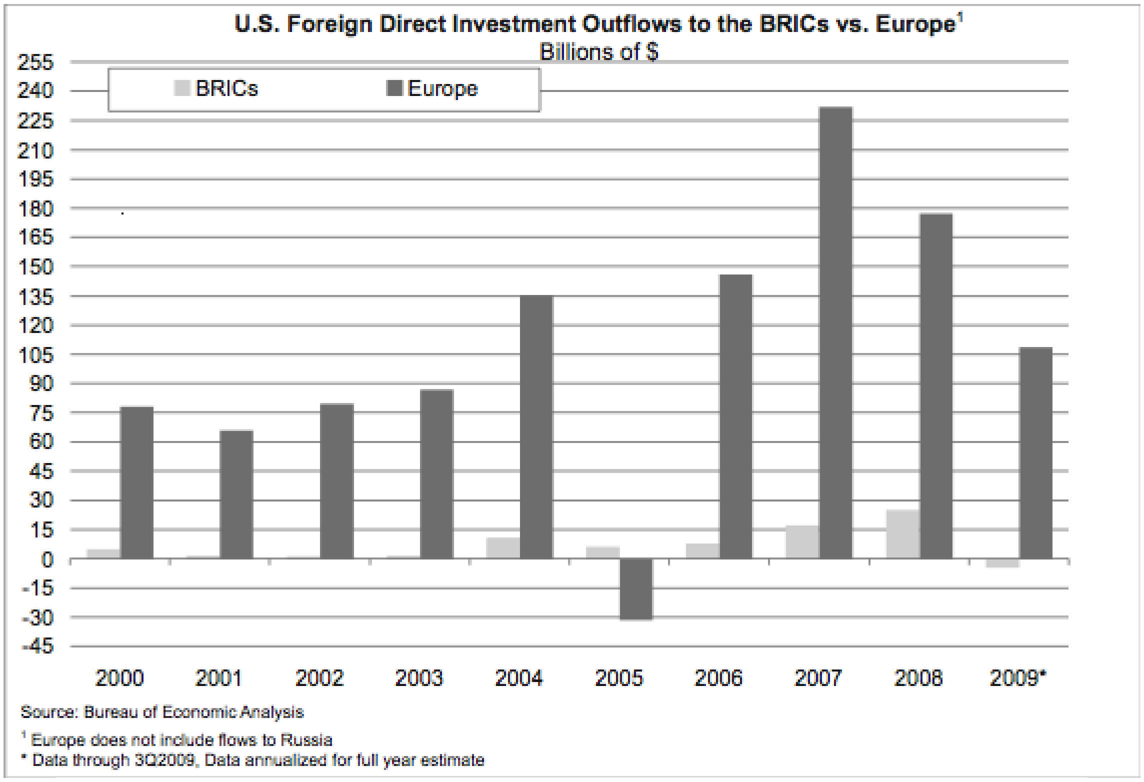
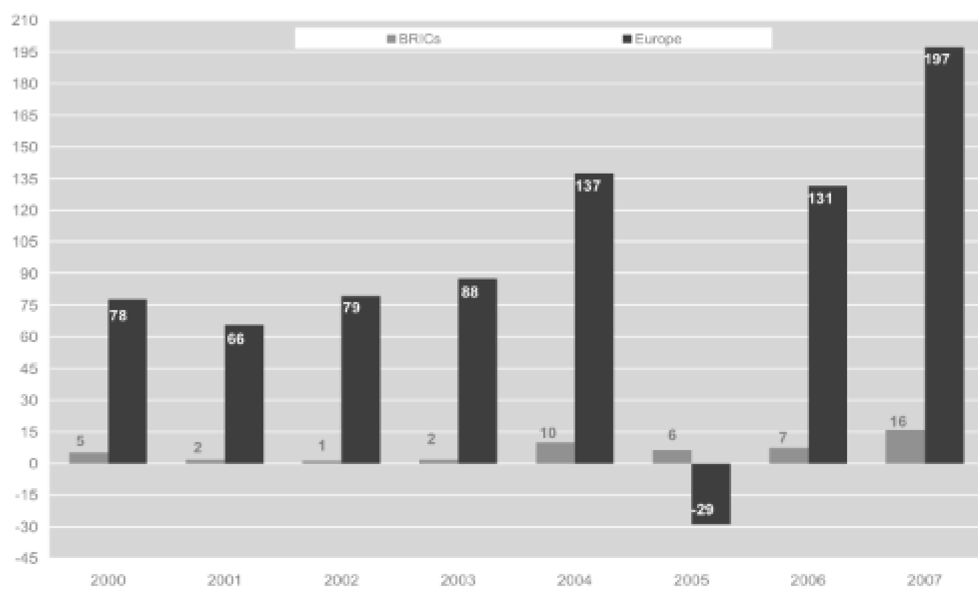


U.S. Foreign Direct Investment Outflows to the BRICs vs. Europe

$ billions



Source: Bureau of Economic Analysis

Hamilton and Quinlan, "The Transatlantic Economy 2010: Annual Survey of Jobs, Trade, and Investment between the United States and Europe"

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