

Creating the Transatlantic Marketplace

By Daniel S. Hamilton¹

It is fashionable these days to proclaim the transatlantic partnership passé. Such loose talk, however, ignores two bottom-line economic facts. First, despite the rise of key developing economies, the economic relationship between North America and Europe is by a wide margin the deepest and broadest between any two continents in history. Second, these ties that bind have become stronger, not weaker, since the end of the Cold War, and have tightened considerably despite the political tensions that have marked the relationship in this decade. Europeans and Americans have become so intertwined that we are literally in each other's business. These linkages underpin a \$4 trillion economy that provides up to 14 million 'onshored' jobs on both sides of the Atlantic.

The Transatlantic Economy Today

Although the reality of deep transatlantic integration is plain to see, it is readily overlooked or underappreciated. One key reason is a tendency among journalists and politicians to equate trade with commerce. Exports and imports have become the most common measurement of cross-border business between nations. On this basis, it seems as if other markets may be more important to the U.S. and Europe than they are to each other, and also that the U.S. and Europe spend more time fighting over trade than facilitating it.

Transatlantic trade squabbles steal the headlines. But they account for only 1-2 percent of transatlantic commerce. In fact, trade itself accounts for less than 20 percent of transatlantic commerce. Trade alone is a misleading benchmark of international commerce, and particularly of the economic relationship across the Atlantic.

The real backbone of the transatlantic economy is foreign investment, not trade—and most U.S. and European investments flow to each other, rather than to rapidly developing countries. When one adds investment and trade together, it becomes clear that overall, the U.S. and Europe remain each other's most important foreign source of jobs and profits. Europeans and Americans literally own each other.

On a historic cost basis, America's investment stakes in Europe rose to \$1.2 trillion in 2006, or nearly 53 percent of the global total, nearly three times larger than corporate America's investment position in all of Asia and more than double its cumulative stakes in the developing nations. Corporate America's investment position in Ireland alone in 2006 (\$83 billion) was larger than America's total investment stakes in the BRICs: Brazil, Russia, India, and China (\$73 billion).

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Europe remains by far the most profitable region of the world for U.S. multinationals. Europe accounted for roughly half of total U.S. global earnings in 2006 and a similar share in the first half of 2007. During this decade, Europe has accounted for 55 percent of total U.S. global earnings. U.S. affiliate income from Europe in 2006 was nearly three times as large as total earnings from Latin America and more than double affiliate earnings from Asia.

Similarly, the United States remains the primary destination of EU investment in terms of FDI flows and outward stock. No other region of the world has invested as much in the United States than Europe, with the latter accounting for roughly 75 percent of total inward investment stock in 2006, an increase in Europe's leading role over the previous year.

In 2005, EU investment in the U.S. totaled €29 billion versus total combined investment of €8 billion in China and India. Investment in China totaled €6 billion, while EU investment in India tallied just €2 billion. Overall European investment in China is less than German investment alone in the U.S. state of New Jersey. Total European investment in India is less than half of German investment in a single U.S. state such as Missouri or South Carolina.

The U.S. remains a key profit center for European companies. German-owned affiliates in the U.S., for instance, sold \$343 billion in 2005, more than four times German exports to the United States of \$86.1 billion. European affiliate earnings from India and China combined totaled €4.2 billion in 2005, less than 8 percent of what European affiliates earned in the United States.

Barriers Remain

Transatlantic markets are among the most open in the world and are deeply integrated through dense flows of investment, affiliate sales, and related-party trade. Yet various barriers persist that prevent the emergence of a free transatlantic marketplace. These include traditional tariff barriers, as well non-tariff barriers and regulations that restrict foreign ownership of domestic resources, assign monopoly status to government enterprises, pose significant regulatory hurdles for prospective foreign investors, or discriminate between domestic and foreign bidders.

Because transatlantic tariffs are generally quite low and European and U.S. industries are so deeply intertwined with each other, non-tariff barriers are more important impediments to a free transatlantic marketplace. Remaining non-tariff barriers consist largely of domestic regulations, including safety norms, different health, environmental or engineering standards, rules of origin, or labeling requirements. Such measures are due in part to different societal preferences and priorities, but also to a significant degree to a lack of coordination or adequate information exchange between regulators and legislators on each side of the Atlantic, who are subject to different legal mandates or engage in different oversight procedures.

In June 2005, an OECD report² estimated that a package of structural reforms in the EU and the U.S. that included reduction of competition-restraining regulations, tariff barriers, and FDI restrictions could lead to permanent gains in GDP per capita on both sides of the Atlantic of up to 3 to 3.5 percent, and cause additional benefits to other OECD countries of up to 1.5 percent of GDP per capita. Over the course of an average 40-year working life of an individual, the OECD estimates that the cumulated addition to earnings would equal between one-half and more than a full year's worth of earnings.

In short, given the size and the deep inter-linkages between the U.S. and European economies, the removal of remaining tariff and non-tariff barriers, coupled with enhanced economic and regulatory cooperation between the U.S. and the EU, could be the catalyst for a significant boost in economic growth, employment, investment, and innovation across the transatlantic marketplace, and could further enhance the attractiveness of the transatlantic economy in a globalizing world.

The Transatlantic Economic Council and its Critics

Efforts to liberalize transatlantic markets by focusing on domestic barriers began with the 1995 New Transatlantic Agenda, and have been continued with varying degrees of enthusiasm by the U.S. and EU. The newest incarnation has been the creation of the Transatlantic Economic Council (TEC) in 2007, headed currently by European Commission Vice President Günther Verheugen and Daniel Price of the National Economic Council in the White House. The initiative was advanced particularly forcefully by German Chancellor Angela Merkel during the German EU Presidency during the spring of 2007. The goal of the TEC is to identify and if possible remove barriers to the free flow of goods, services, technology, and ideas across the Atlantic.

As soon as Merkel broached the topic, critics sharpened their knives. Most confused her initiative with the old and largely discarded idea of a U.S.-EU Transatlantic Free Trade Area (TAFTA), which they argued would be so big it would destroy the multilateral trading system. Such criticism, however, falsely characterizes the initiative or misses the point.

The initiative is not about the Doha Round or other trade initiatives because trade really isn't the problem across the Atlantic. Transatlantic trade tiffs steal the headlines, but overall, transatlantic trade barriers are very low. Since the transatlantic economy is driven by investment more than trade, the most important transatlantic economic obstacles are not "at the border" trade barriers but "behind the border" domestic barriers to the free flow of capital, goods, and services. Moreover, given the immense size of the transatlantic market, even small changes in domestic regulations could generate far bigger economic payoffs than further tariff reductions. The positive impact of transatlantic open skies alone, for instance, would be about \$6 billion for both the U.S. and EU economies, about the same as the Doha Round.

Transatlantic markets are the laboratory of globalization. Given deep transatlantic integration, Europeans and Americans face issues that neither yet faces with others. That is why the "multilateral versus transatlantic" dichotomy is a false choice. The United

² OECD, "The Benefits of Liberalising Product Markets and Reducing Barriers to International Trade and Investment: The Case of The United States and the European Union," *Economics Department Working Paper 432*, Paris, June 2005.

States and EU should advance on both fronts simultaneously: push multilateral liberalization through Doha and press transatlantic market-opening initiatives in services, financial markets, telecommunications, energy, innovation policies, and other areas not yet covered by multilateral agreements. The alternative is not drift; it is growing protectionism and U.S.-EU rivalry in third markets.

Conclusion

There could be much potential in a truly transformative initiative that goes beyond trade and seeks a mutual opening of the EU's single market and America's vast continental market. The benefits would be widespread, reaching across many sectors. The payoff could be substantial—the equivalent of giving every American and every European an entire year's extra salary over their working lifetimes.

The key now is to engage two important constituencies: legislators and regulators. Deep transatlantic integration can mean that domestic non-tariff measures can become transatlantic non-tariff barriers. Most of this is not willful; domestic regulatory agencies are simply not designed to take into account the deeply—but unevenly—integrated nature of the transatlantic marketplace. Regulatory authorities, of course, have the duty to ensure that specific products are suitable for use in their jurisdiction. Given deep integration, however, greater consistency and coordination among EU and U.S. risk assessment and regulatory review procedures can benefit companies, consumers and the broader public.

The TEC promises to break new ground in this regard by enabling regular communication and exchange of information on a variety of health, safety, environmental, consumer protection, and security standards, examining different approaches to risk assessment. A key premise of such efforts could be recognition of the essential 'equivalence' of testing and regulatory procedures, which are rigorous on both sides of the Atlantic. Rather than seeking to harmonize all standards, an impossible task that is likely to create more rather than less bureaucracy, each side could agree to mutual recognition of their respective standards, much as the member states of the European Community agreed to achieve between themselves in the 1980s. Unfortunately, neither the Bush administration nor the European Union has given the TEC the priority it should command.

Merkel has posed the right question: Shouldn't Europeans and Americans position themselves to absorb the shocks of global economic change and be true pathfinders of the global economy, rather than waste their time on banana-and-beef trade disputes and fruitless competition to eke out marginal advantage in third markets? The test is now whether the Transatlantic Economic Council will be able to deliver on its potential. A concerted effort to create a truly free transatlantic market could generate significant benefits in growth, jobs, and consumer welfare on both sides of the Atlantic.

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