



THE TRANSATLANTIC ECONOMY 2006

EXCERPTS FROM THE PUBLICATION
BY DANIEL HAMILTON AND JOSEPH QUINLAN



Daniel Hamilton & Joseph Quinlan

**Center for Transatlantic Relations,
School for Advanced International Studies,
Johns Hopkins University**



Daniel S. Hamilton is the Richard von Weizsäcker Professor and Director of the Center for Transatlantic Relations at the Paul H. Nitze School of Advanced International Studies (SAIS), Johns Hopkins University; and Executive Director of the American Consortium on EU Studies (ACES), a cooperative venture among five major universities in the nation's capital designated by the European Commission as the EU Center of Excellence in Washington DC. Dr. Hamilton is publisher of *Transatlantic: Europe, America & the World*, the Center's bi-monthly magazine on transatlantic issues. He leads the international policy work of the Johns Hopkins-based US National Center of Excellence on Homeland Security, awarded by the US Department of Homeland Security.



Joseph P. Quinlan is a Senior Fellow at the Center for Transatlantic Relations. He specialises in global capital flows, international trade and multinational strategies. He has extensive experience on Wall Street and in the US corporate sector. He lectures at New York University and was appointed as an Eisenhower Fellow in 1998. His publications have appeared in such venues as *Foreign Affairs*, the *Financial Times* and the *Wall Street Journal*.

About the Center for Transatlantic Relations

The SAIS Center for Transatlantic Relations, located near Dupont Circle in Washington, DC, engages international scholars and students directly with government officials, journalists, business executives, and other opinion leaders from both sides of the Atlantic on issues facing Europe and North America. The goal of the Center is to strengthen and reorient transatlantic relations to the dynamics of the globalising world. Center activities include seminars and lectures, media programs and web-based activities, research projects, and policy study groups.

The Center is an integral part of the Paul H. Nitze School of Advanced International Studies (SAIS), one of America's leading graduate schools devoted to the study of international relations.

Executive Summary

Although recent years have been among the worst of times for transatlantic political relations, they have been the best of times for the transatlantic economy.

Since hitting a cyclical bottom in 2001/02 due to the bursting of the US technology bubble and the subsequent US recession, transatlantic trade, investment and corporate profits have soared in recent years, with the United States and Europe each leveraging off each other's strengths.

Strong economic growth in the United States has been a key catalyst in boosting corporate earnings in Europe, which in turn have helped to promote more investment and employment growth across the continent.

Meanwhile, the enlargement of the European Union, coupled with micro reform in various key nations such as Germany, has been a windfall for US multinationals, many of which have enjoyed record profits growth over the past three years.

Despite all the transatlantic political bickering, the hype associated with the rise of China and India, and constant warnings of a transatlantic divorce, the bilateral economic bonds of the United States and Europe have only grown stronger since the beginning of this decade.

We estimate that the transatlantic economy continues to generate roughly \$3 trillion in total commercial sales a year and employs up to 14 million workers in mutually 'insourced' jobs on both sides of the Atlantic who enjoy high wages, high labour and environmental standards, and open, largely non-discriminatory access to each others' markets.

The transatlantic economy remains at the forefront of globalisation: trade and investment ties between the United States and Europe are deeper and thicker than between any other two continents. This is evident from the most recent data available.

Investment First, Trade Second

The years since the end of the Cold War—the years when the fading “glue” of the Cold War partnership supposedly loosened transatlantic ties— have marked in fact one of the most intense periods of transatlantic integration ever.

Despite the hype about the significance of NAFTA and the stunning economic rise of Asia, transatlantic investment flows remain quite strong. Over the first half of this decade, for instance, Europe accounted for just over 57% of total US foreign direct investment (FDI) outflows. In turn, Europe accounted for over 75% of total US FDI inflows over the same period.

In 2005, European investment inflows to the US totalled \$66.1 billion, an increase of more than \$13 billion over 2004 levels. Europe accounted for roughly two-thirds of total global investment flows into the United States in 2005, slightly less as a percentage of the overall total than in 2004, but still far and away the most significant source of foreign investment in the US economy.

European FDI to the US remained strong in the first half of 2006, with inflows of \$61 billion - roughly three times the level of the same period for 2005.

2005 was an unusual year for US investment flows to the world, including to Europe, due to the passage of the American Jobs Creation Act of 2004. This act offered a one-time incentive to US multinationals to repatriate earnings back to the United States. For a variety of reasons, many American firms did just that. Rather than reinvesting their earnings in European operations, as is often the case, many US firms repatriated capital back home. Because reinvested earnings are one of three key components of foreign direct investment, a decline in reinvested earnings is typically associated with a decline in total FDI. Indeed, in 2005 there was a net outflow of US FDI from Europe of \$37.5 billion, in contrast to a net inflow of \$93 billion in 2004. As discussed, 2005 was an atypical year due to this one-off legislative provision of tax incentives.

In 2006 strong US FDI flows to Europe quickly resumed their normal pattern, totaling \$51 billion in the first half of the year alone, up 53% from the same period in 2005. Europe accounted for 47% of total US FDI in the first half of 2006.

Even with the 2005 anomaly, US investment flows to Europe considerably outweighed US investment elsewhere. For example, while US foreign direct investment to China has increased sharply over the past few years, total US investment in China last year (\$1.6 billion) was just 23% of total US investment in Belgium in 2005. US investment in Germany was roughly four-and-a-half times larger than US investment in China in 2005.

US investment in France, while down due to the repatriation of US reinvested earnings in 2005, was still some 16.7% greater than what US firms invested in India.

On a historic cost basis, the US investment position in Europe was nearly three times larger than corporate America's investment position in all of Asia at the end of 2005.

US investment stakes in Italy at the end of 2005, some \$26 billion on a historic cost basis, were greater than the combined US investment position in China and India (\$25.4 billion).

Europe as a Key Source of Capital for the US

Europe is not only a critical source of revenue for US multinationals, it is also a key supplier of capital or liquidity for the debt-stretched United States. In 2005, European purchases of US assets (US treasuries, government agency bonds, corporate bonds and US equities) soared to a record \$470.4 billion. The bulk of the capital came from the United Kingdom (\$362 billion), Europe's primary financial hub and capital transit point for investment from the Middle East, Russia and other points. However, even after excluding inflows from the UK, EU capital inflows to the US totaled \$108 billion in 2005, a 76% jump from 2004.

The Transatlantic Boom in Profits

Europe is the most important commercial market in the world for corporate America by a wide yet unappreciated margin. In 2005, for instance, US foreign affiliate income from Europe surged to a record \$106 billion, a figure equivalent to just over 46% of total US foreign affiliate income.

US foreign affiliate earnings of \$106 billion in Europe in 2005 were more than double affiliate earnings derived from all of Asia (\$50.4 billion).

In 2005, US affiliates posted record earnings in the United Kingdom (\$19.9 billion), Ireland (\$12.4 billion), Germany (\$6.7 billion), Italy (\$2.9 billion), and Norway (\$2.7 billion).

Total US foreign affiliate income earned in Poland, Hungary and the Czech Republic has soared over this decade, even if from a small base. US affiliate income in these three countries collectively totaled \$1.5 billion in 2005, triple the level of 2000. US affiliates earned more in these three markets last year than they did in India (\$1.1 billion), a much larger and over-hyped market.

Just as Europe is the most important foreign market in the world for American firms, the US is the top overseas market for European multinationals. Indeed, strong sales and profits in the United States have been a catalyst behind Europe's booming equity markets of the past few years.

In fact, to an important degree Corporate Europe's earnings boom has been "Made in America," with annual earnings of European affiliates in the US soaring to a record high in 2005. Between 2001 and 2005 European affiliate earnings in the US rose more than five-fold, from a cyclical low of \$14 billion in 2001 to \$77 billion in 2005. Last year, the combination of strong US economic growth and a weak euro versus the dollar helped boost affiliate income of European affiliates to record highs.

French affiliate earnings in the US surged 30% in 2005 from the prior year, to a record \$11.4 billion. Income earned by German affiliates in the US rose by nearly 26% in 2005, to a record \$7.8 billion. British affiliates posted usually strong earnings, with affiliate income rising to nearly \$30 billion in 2005, a 50% jump from the prior year.

Transatlantic Service Ties Have Only Grown Stronger - Driven by Investment

The service economies of the United States and Europe have never been as intertwined as they are today, notably in such activities as financial services, telecommunications, utilities, insurance, advertising, computer services, and other related activities.

Foreign affiliate sales of services on both sides of the Atlantic have exploded over the past decade. In fact, affiliate sales of services have not only supplemented trade in services to become a viable second channel of delivery for US and European multinationals, they have become the overwhelming mode of delivery in a rather short period of time.

Sales of services of US foreign affiliates in Europe soared again in 2005, rising to a record \$265 billion. US affiliate sales of services were 81% larger than US service exports to Europe last year. The United Kingdom accounted for nearly 40% of US foreign affiliate sales of services in 2005. On a global basis, Europe accounted for 53% of total US affiliate sales of services last year.

Sales of services by US affiliates of European firms have also soared over the past decade. As Europe's investment position in services has expanded in the US, so have Europe's foreign affiliate sales of services. In 2005, affiliate sales of services in the US totaled \$260.6 billion, more than double US service imports from Europe in the same year (\$123 billion). In total, Europe accounted for 68% of total US affiliate sales last year.

Transatlantic trade in services also remains substantial. Europe accounted for 40% of total US service exports and for 44% of total US service imports in 2005. Five of the top ten US export markets for services in 2005 were in Europe. The United Kingdom ranked first, Germany fifth, France sixth, Switzerland eighth and the Netherlands tenth. Similarly, among the top ten importers of services to the US, five were from Europe in 2005. The UK ranked first, Germany fourth, France seventh, Switzerland eighth, and the Netherlands ninth.

The US enjoyed a \$22.4 billion trade surplus in services with Europe in 2005; however, that stands in sharp contrast to the US \$124 billion trade deficit in goods with Europe in the same year.

Europe's Investment Base in the US Continues to Expand

Corporate Europe's asset base in the US totalled \$4.2 trillion in 2004, a rise of 7.7% from the prior year. Europe accounted for over 75% of total foreign-owned assets in the US in 2004.

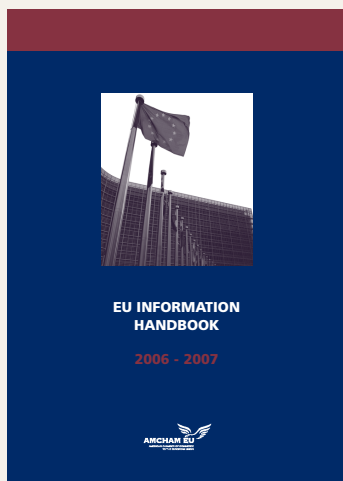
European foreign affiliates directly employed over 3.5 million Americans in 2004, with British firms the top employer of US workers. Germany and the Netherlands ranked second and third, respectively.

The output of European foreign affiliates in the US rose to \$337 billion in 2004, a 7.5% increase from the prior year. European firms accounted for 65% of total foreign affiliate output in the US in 2004.

The American Chamber of Commerce to the European Union (AmCham EU) is the voice of companies of American parentage committed to Europe towards the institutions and governments of the European Union. It aims to ensure a growth-oriented business and investment climate in Europe. AmCham EU facilitates the resolution of EU - US issues that impact business and plays a role in creating better understanding of EU and US positions on business matters.

AmCham EU Publications

The 19th edition of the EU Information Handbook contains fully updated and revised information, including contact details for Perm Reps, MEPs, the EP Secretariat, Commission DGs, Cabinets, Services and Secretariat General, and a comprehensive explanation of how the European institutions work.



I would like to order _____
copy/copies of the
EU Information Handbook

Price: €90 non-members;
€75 AmCham Global members;
€60 AmCham EU members

ISBN: -2-914685-49-1

Discounts available for bulk orders, book sellers, libraries & educational institutions

AmCham EU also produces a highly acclaimed series of publications you may wish to order:

- copy(ies) of The Guide to the Council of the European Union (ISBN -2-914685-48-3)
€75 non-members; €60 AmCham Global members; €50 AmCham EU members (194 pages)
- copy(ies) of The EU Made Simple (ISBN -2-914685-46-7)
€30 universal price (158 pages)
- copy(ies) of Understanding EU Financial Services Legislation (ISBN -2-914685-25-4)
€30 universal price (103 pages)
- copy(ies) of the EU Policies: A Guide for Business 2005-2006 (ISBN -2-914685-33-5)
€75 non-members; €60 AmCham Global members; €50 AmCham EU members (251 pages)
- copy(ies) of the Guide to the WTO 2005-2006 (ISBN -2-914685-54-9)
€75 non-members; €60 AmCham Global members; €50 AmCham EU members (147 pages)

Name: _____

Organisation/Company: _____

Address: _____ Post code: _____ City: _____

Tel: _____ Fax: _____

E-mail: _____

PAYMENT

Credit card

AmEx

Visa

MasterCard

Card No.: _____ Exp. Date: _____

Signature: _____

Your VAT number _____

Tick if you do not have a VAT number.

All prices are without VAT. Please add 6% if you are outside the EU or do not have a VAT number in the EU.

* Please add €12.10 for bank transactions if payment is made outside the EU; add €5 per book for postage & handling costs inside the EU; add €10 per book for postage & handling costs outside the EU

**Complete this form and return by mail or fax, with appropriate payment,
to the address below**

Avenue des Arts 53 ■ 1000 Brussels ■ Belgium ■ Tel: 32-2 513 68 92 ■ Fax: 32-2 513 79 28
amchameu@amchameu.be ■ www.amchameu.be