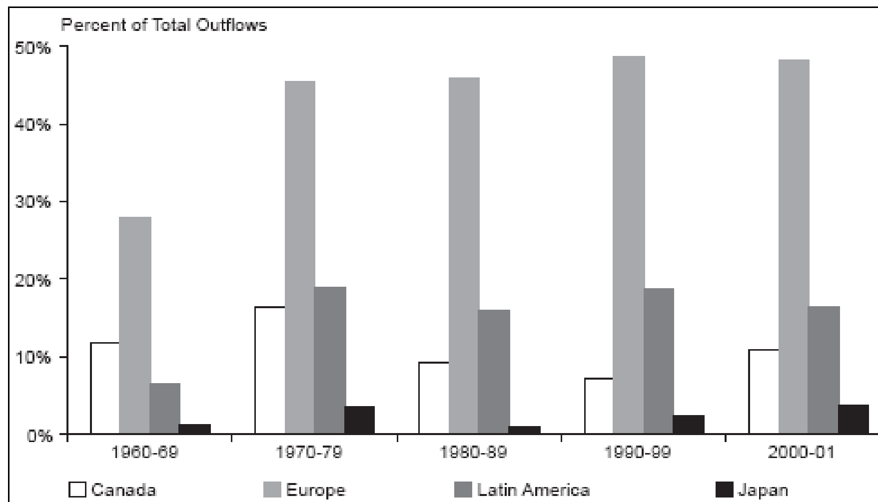
Transatlantic Investment: Towards a Transatlantic Marketplace?

Decades of mutual financial investment have led to the close integration of the transatlantic economies. At times, economic interdependence has led to disputes, based on regulatory differences or divergent legal traditions. In their attempt to smooth these disputes and reap added economic benefits, the transatlantic partners have committed themselves to create a fully-integrated transatlantic marketplace by 2015, promising to cement the dominance of EU-US relations in world markets. However, as the world is heading for its deepest recession in decades, fundamental questions are being raised about the sustainability of the transatlantic economy. This brief examines the role of transatlantic investment and the future of transatlantic economic ties.

Transatlantic Investment: General Trends

Ever since the end of the Cold War, commercial ties between the United States and Europe have broadened and deepened, leading to a high-level of economic integration amongst the transatlantic partners. Nowhere is this more pronounced then when it comes to transatlantic investment. While in the 1950s Canada and Latin America were the recipients of 70% of US foreign direct investment (FDI), by the late 2000s the European Union (EU) has become the prime location for US investment, accounting for around 50% of US FDI. Moreover, Europe has been the preferred destination for US investment for over forty years, leading to the accumulation of large stocks of European assets; a full 62% of the United States' $11.5 trillion foreign assets in 2006 were located in Europe.[1]

US FDI abroad 1960-2001[2]



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The same has been true for the European Union, which has sunk large amounts of FDI in the US market over the past decades. Indeed, EU investments have accounted for over 60% of all FDI going to the US for every year since the late 1990s.[3] The European countries traditionally receiving the largest share of US FDI have been the UK, the Netherlands, Germany and France. The reverse also holds true, with the UK, Germany and the Netherlands regularly being the largest investors in the US economy. As a result of these long lasting ties, by the end of 2006, European firms held some $5 trillion in US assets, equivalent to three-quarters of foreign assets in the US.

A considerable share of these investments was in the form of transatlantic mergers and acquisitions (M&A). Transatlantic M&A deals have been on the rise for nearly 5 years, peaking in 2007. For 2007, EU M&A inflows to the United States exceeded $200 billion, higher than ever before. Over the same period, US M&A activity in the European Union was close to $180 billion. In 2008 M&A activity declined, with EU acquisitions of US firms totaling $175 billion and US acquisition of European firms some $91 billion. Given the current crisis of international credit markets, this decline is not surprising.[4]

EU-27 FDI flows (€ millions)[5]

	EU27 FDI in the USA (outward)			USA FDI in the EU27 (inward)			Net EU27 FDI flows (outward minus inward)		
	2005	2006	2007	2005	2006	2007	2005	2006	2007
EU27*	36 525	108 033	145 560	67 153	76 724	180 037	-30 628	31 309	-34 477
Belgium	5 190	2 505	-6 114	3 900	1 254	3 557	1 290	1 251	-9 671
Bulgaria	2	12	9	83	243	148	-81	-231	-139
Czech Republic	10	8	16	92	-15	254	-82	23	-238
Denmark	154	1 444	1 755	737	-362	1 234	-583	1 806	521
Germany	896	20 931	15 980	470	4 111	-4 630	426	16 820	20 610
Estonia	-1	2	5	-53	-105	10	52	107	-5
Ireland	-3 402	4 161	4 439	1 158	-667	16 505	-4 560	4 828	-12 066
Greece	1	45	130	97	130	85	-96	-85	45
Spain	1 948	8 769	11 795	2 035	5 525	1 782	-87	3 244	10 013
France	9 897	17 541	22 866	6 247	8 695	16 595	3 650	8 846	6 271
Italy	1 185	4 852	1 267	910	1 346	720	275	3 506	547
Cyprus	4	5	4	65	26	27	-61	-21	-23
Latvia	3	3	0	-1	60	29	4	-57	-29
Lithuania	0	0	0	-91	16	-23	91	-16	23
Luxembourg	3 555	19 183	19 666	1 856	5 072	22 730	1 699	14 111	-3 064
Hungary	9	7 087	8 642	200	1 553	4 267	-191	5 534	4 375
Malta	0	2	2	7	11	5	-7	-9	-3
Netherlands**	1 322	3 689	-21 300	907	975	15 185	415	2 714	-36 485
Austria	157	230	423	218	-1 570	3 191	-61	1 800	-2 768
Poland	50	106	30	643	414	832	-593	-308	-802
Portugal	94	158	369	-313	297	329	407	-139	40
Romania	0	1	0	22	133	60	-22	-132	-60
Slovenia	-22	12	-20	25	0	4	-47	12	-24
Slovakia	1	-3	1	53	93	3	-52	-96	-2
Finland	105	-1	-628	203	111	55	-98	-112	-683
Sweden	-495	-275	5 072	-676	7 978	-377	181	-8 253	5 449
United Kingdom	24 399	-2 598	47 327	22 798	18 061	39 745	1 601	-20 659	7 582

Years of transatlantic investments mean that both economies are now intimately entangled. Some analysts have pointed out that the total output of foreign affiliates in

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Europe ($541 billion in 2006) and of European affiliates in the US ($392 billion) now by far exceed the output of most nations and are of great economic importance to both transatlantic partners. When it comes to employment, a similar picture emerges. Thus, in 2006, US affiliates in the EU employed some 4 million people, while EU affiliates employed roughly 3.6 million workers in the US. Production processes for many firms have now become so closely integrated that economic problems on one side of the Atlantic easily spill over to the other.

Overall, the massive amounts of investment into each other's markets, translating into billions of dollars of sales, profits, production and employment have meant that both transatlantic partners have had an interest in maintaining a free and open market. But it also meant that regulatory decisions taken by one of the two partners will have a direct impact on the other. In general, both sides have indeed acknowledged that there is little to gain from protectionist investment policies. However, both partners have clashed over the regulation of investment markets and competition rules at times.

Transatlantic Disputes: the Result of Regulatory Differences?

One of the cases where EU and US counterparts have clashed is the Sarbanes Oxley legislation of 2002. Following several highly publicized corporate scandals in the US, including the collapse of Enron, WorldCom and Adelphia, which cost investors billions of dollars, the US administration introduced new legislation that was supposed to tighten corporate standards. These provisions, known as the Sarbanes Oxley Act (SOX), considerably tightened the oversight of US company boards and management and set new accounting standards. Many saw the legislation as controversial because of the additional financial burden that it imposed on companies operating in the US.

In Europe, SOX was criticized particularly for the supposed extra-territorial nature of the legislation, since it applied to all publicly-held companies operating in the US. A common joke in Europe at the time ran: "What does Sarbanes Oxley mean? That's when two members of US Congress fiddle and half a million accountants in Europe start dancing." EU finance ministers reacted with less humor and pointed towards the irreconcilable differences between SOX and the regulatory framework of EU member states.[6] It was widely expected that the legislation would lead to a fall in transatlantic investment and merger activity. In the end the impact seems to have been not very dramatic. Following its own string of corporate scandals, including Parmalat and Vivendi, EU policy-makers revised the EU's Company Law Directive, making compliance with SOX legislation easier to achieve.

Other much discussed examples of regulatory dispute include the EU's decision to prevent the merger of the two US companies General Electrics and Honeywell and the case the EU Commission brought again Microsoft. In both cases the European Commission cited their dominant market position. Its decision had a profound impact on the worldwide operations of these US companies – in the case of Microsoft, the dispute with European authorities seems to be continuing.

The reason that US authorities had no problems with these cases, while the EU authorities intervened, was due to the difference in competition law standards.[7] While the legal systems of both seek to prevent the potentially negative impact on consumers that might derive from market monopolization, both apply different standards. In the case of the US, a certain reduction of consumer welfare might be permissible, as long as the combined effect on producer and consumer welfare remains positive. In Europe, competition laws are primarily focused on the effect of company behavior for consumer welfare. As a result, EU authorities tend to see an abuse of a companies market position in certain cases where US regulators see none.

Overall, regulatory differences or legislative action on one side of the Atlantic can lead to disputes, due to their impact on market participants on the other side of the Atlantic. As a report by the Atlantic Council states, mutual US and European FDI results in "direct participation in each other's domestic economies."[8] Moreover, because of the great weight of the transatlantic economy, these regulatory issues often tend to have a global impact. On the whole, disputes where they arise are the result of the increasing interdependence between the US and the EU economies and therefore necessitate common answers. As a result, repeated attempts have been made between EU and US policy-makers to create a more integrated and regulated common market place.

Creating a Transatlantic Marketplace?

Proponents of greater transatlantic cooperation have often pointed towards the potential economic gains to be made from greater regulatory coordination. According to one report, issued by the OECD in 2005, structural reforms that would reduce competition-related regulations, non-tariff barriers and restrictions on FDI could lead to economic gains of an estimated 3-3.5% of GDP on both sides of the Atlantic.[9] Acknowledging these potential economic gains, transatlantic policy-makers have made some attempts to create a fully-integrated transatlantic marketplace.

The idea to institutionalize closer cooperation on regulatory questions emerged after the Cold War, with the creation of the New Transatlantic Agenda (NTA) in 1995. The NTA envisioned the creation of a transatlantic marketplace, and set up regular EU-US consultations to help dismantle non-tariff barriers and to narrow policy divergences in the areas of regulatory and competition policies. Dialogues with nongovernmental entities – most notably the Transatlantic Business Dialogue – also formed part of the agenda. Ever since, a variety of other initiatives sought to strengthen this process, including the Mutual Recognition Agreements of 1997, the Transatlantic Economic Partnership of 2004 and the Transatlantic Economic Agenda of 2005.[10]

Overall, however, progress with creating a fully-integrated transatlantic marketplace has remained slow. Notwithstanding the eagerness of EU and US policy-makers to regularly demonstrate their commitment to the transatlantic agenda, political expedience often stood in the way of further integration. Many regulatory differences derive at the bottom

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from diverse societal preferences and legal-traditions. More often than not, this makes these issues emotionally and politically loaded, and difficult to reconcile.

The latest attempt to revive transatlantic economic ties originated from the call of German Chancellor Angela Merkel to upgrade EU-US cooperation in 2007. Merkel's initiative led to the adoption of a new EU-US *Framework for Advancing Transatlantic Economic Integration*.[11] The most notable feature of this new framework was the creation of a new institution, the Transatlantic Economic Council (TEC). The TEC is headed by ministerial-appointees from both sides, explicitly tasked with advancing the process of regulatory cooperation. The new agreement also reinforced calls to complete the establishment of a transatlantic market by 2015. To date, this represents the most notable attempt to harmonize regulatory approach on both sides of the Atlantic.

The extent to which the TEC will be able to speed up the establishment of a transatlantic market remains contested. As a new institution, the concrete role of the TEC remains somewhat uncertain and the likelihood of achieving greater regulatory cooperation will in the end depend on the existence of sufficient political will on both sides of the Atlantic.

The Impact of the Economic Crisis

Unsurprisingly, the current economic crisis has had a profound impact on transatlantic trade and investment. Following a brief period of European *Schadenfreude* during which it seemed that Europe's more stable economic fundamentals might remain afloat amidst the global economic turmoil, European economies were sucked into the same economic downward spiral that has affected the US. This should not have been surprising, given the profound level of integration amongst the two economies. As previously demonstrated, trade and investment ties between the two transatlantic partners have made it virtually impossible to isolate themselves from economic troubles in each other's economies.

Unavoidably, the unprecedented global economic crisis the world is experiencing right now is leading to some stagnation in transatlantic economic relations. FDI from France to the US plunged by close to 80% on the previous year, compared to a fall of 40% for FDI from Germany. Other European countries are not far behind. Simultaneously, in 2008 US capital flows to the EU declined by 11% in the first half of the year and seem to have fallen even further since then. Transatlantic trade has also suffered greatly, creating problems especially for Europe's more export oriented economies such as Germany.

Recent events also suggest that the crisis has the potential to unwind at least some transatlantic investment flows. The efforts by large financial firms to consolidate their portfolios in the US provide one such example. Thus, the sudden flow of investment funds out of the UK has led to a sharp depreciation of the pound against the dollar. Where the pound traded at over $2 in the summer of 2008, it quickly dropped to below $1.50. This portfolio rebalancing started with the most liquid assets, like financial securities, but it could soon spread to less liquid forms of foreign direct investment. Indeed, the evidence from Ireland suggests it may already have.

Other signs seem to indicate the potential for a political backlash. On February 6, 2009, on French television, French President Nicolas Sarkozy complained that more jobs needed to be preserved in France and called on French multinationals, such as carmaker Peugeot, to repatriate their investments. This call was ostensibly directed at the lower-wage economies of Central and Eastern Europe, where French firms relocated some of their production facilities. Worryingly, some seem to be following his call.[12] Should the crisis continue and protectionist sentiment spread, the same could happen to transatlantic investment as well. Initial responses from the United States have been muted, and yet the prospect for a conflict over the free movement of capital across the Atlantic remains.

For now, both of these developments are likely to prove temporary in nature. Diversification requirements will encourage US firms to begin investing abroad and political realities will force Sarkozy to give his own multinationals looser reins. Nevertheless, it is useful to note that the transatlantic investment relationship cannot be taken for granted. Only careful nurturing of that relationship can ensure that both sides continue to profit from it in the future as much as they have in the past. Moreover, much depends on the eventual recovery of economic dynamism on both sides of the Atlantic.

A recent paper by Dan Hamilton and Joseph Quinlan puts this succinctly: "does the current recession mark the end of the consumer-friendly model of deepening integration, driven by easy credit and extensive investment links, which characterized the post-Cold War transatlantic economy?"[13] If the transatlantic partners are indeed able to use the current crisis to lay the foundation for a new period of economic growth, the crisis will likely be no more than a brief pause in transatlantic economic ties. However, if the answer is yes, then the future of a fully-integrated transatlantic market remains in jeopardy, and an unraveling of economic ties a real possibility.

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[1] Joseph Quinlan (2003), "Drifting Apart or Growing Together? The Primacy of the Transatlantic Economy", Washington, DC: Center for Transatlantic Relations
[2] Ibid.
[3] Congressional Research Service (2008), "European Union-U.S. Trade and Investment Relations: Key Issues", April 8, 2008
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[10] Congressional Research Service (2008), "Transatlantic Regulatory Cooperation: a possible Role for Congress", November 7, 2007

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[11] US-EU Framework for Advancing Transatlantic Economic Integration, April 2007
[12] French car-maker Renault announced in April 2009 that it would repatriate the production of one of its car-models from its Slovenian plant at Novo Mesto back to Flins in France.
[13] Daniel Hamilton & Joseph Quinlan (2009), "The Transatlantic Economy 2009", Washington, DC: Center for Transatlantic Relations, p. 12

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