



Why the EU matters to North Carolina

As China's rapid economic and military rise holds the attention of US policymakers and public alike, comparatively little thought is given to the EU. A narrative of European decline has slowly become predominant as the economic crisis spread to Europe and fears of a complete breakup of the Euro emerged. The duration of the crisis in Europe, as compared to the US, contributed to the perception of the EU as economically uncompetitive and sluggish, politically divided, and unhelpful to the US on the international stage. Yet this image is wrong and the notion that Europe is becoming less important to the US is profoundly misleading. The focus on the 'rise of Asia' has concealed the depth of the transatlantic economy and the EU's continuing importance to the US. At \$16.2 trillion, the EU's is the second largest economy in the world, only slightly smaller than the US, estimated at \$16.8 trillion in 2013.¹ The European and US economies form the most tightly interlinked economic area in the world, connected by ties that run much deeper than those of any other economic relationship. This brief argues that Europe still matters to the US and particularly to North Carolina, both because of its economic weight and in political terms. Part I illustrates the depth of the economic ties between the US and EU, showing that North Carolina is an integral part of the transatlantic economy. Part II argues that the EU remains the pre-eminent partner to the US in many fields from international security to trade liberalization and the promotion of international development. Part III sketches out prospects for the future, arguing that the Transatlantic Trade and Investment Partnership (TTIP) presents an opportunity to tighten the transatlantic relationship, boosting growth opportunities on both sides of the Atlantic.

Deep Economic Links

The sheer size of the combined US and EU economy, accounting for 40% of global GDP in purchasing power parity (PPP) terms, means that it is the engine of the global economy. Economic interconnectedness is such that it is possible to talk of a transatlantic economy, encompassing the US, the EU and those countries participating in the EU's single market: Norway, Iceland, Switzerland and Lichtenstein. Trade is an important contributor to the tight links between the EU and US: both are each other's main trading partners. US goods trade with the EU amounted to \$650 billion in 2013, whereas trade in services was \$368 billion.² The US recorded a trade deficit in goods of over \$125 billion, but services recorded a \$52 billion surplus. Compared to China, US exports of goods were more than twice in volume, and those in services over six times. And yet, the importance of trade in US-EU economic relations is dwarfed by the size of investment in each other's economies. The scale of foreign direct investment (FDI) reflects a deeper degree of integration and linkage compared to a relationship based purely on trade. Indeed, most US-EU trade takes place indirectly as goods are delivered through foreign affiliate sales, thus reflecting FDI, rather than through direct imports and exports. Sales of US affiliates in Europe amounted to \$2.6 trillion in 2011, a figure almost six times larger than US

exports to the EU.³ In 2011, total assets of European affiliates in the US stood at over \$7 trillion. By comparison, US assets of affiliates headquartered in the Asia-Pacific region stood at just \$2.1 trillion.⁴ Flows of European FDI to the US reflect a similar pattern: in 2013 they amounted to \$83.6 billion, a slight decrease from previous years, but still well over the \$50.6 billion from the Asia-Pacific.⁵ Foreign investment in the US is a source of jobs for the economy: in 2011, 5.6 million workers were directly employed by foreign affiliates in the US. Out of these workers, firms from the EU employed 3.3 million.⁶ However, this number does not reflect the total impact of links with the EU on employment in the US, seeing as it does not include jobs tied directly to importing and exporting, as well as those created through supplier and distribution networks. On the whole, it has been estimated that 15 million jobs depend on transatlantic trade, foreign investment and foreign affiliates in the US and EU.⁷ European foreign affiliates in the US also contribute to research and development, investing over \$24 billion in 2011, up from \$22 billion in 2010.⁸ European investments in the US only make up half of the picture: the US has also invested extensively in the EU. Of \$22.9 trillion in American overseas assets in 2011, fully \$12.2 trillion were in the EU whereas only \$330 billion were in China.⁹ US investment in single European countries, such as the UK, dwarfed that in other regions and even continents. On the whole, the EU remains the most attractive location in the world for American capital, and its attractiveness seems to have grown over time. Between 2000 and 2009, 49% of global US FDI went to the EU; between 2010 and 2013 this proportion had risen to 52%. By means of comparison, only 1.4% of US FDI went to the Asia-Pacific region between 2010 and 2013.¹⁰ This shows that as US companies turn their attention to new markets and consumers, they are hardly moving away from Europe.

The tight interconnectedness between the US and EU economies means that repercussions can be strong. This was evident with the onset of the economic crisis in 2008. Before the onset of the crisis, in 2008, exports of US goods and services and income receipts from the EU stood at \$805 billion. By 2009, they had dropped sharply to \$645 billion and have not yet fully recovered. The data reveals that exports of goods and services have broadly recovered, while income receipts on US owned assets and direct investment receipts remain markedly lower than pre-2008 levels.¹¹ Flows of EU FDI in the US have also dropped sharply compared to pre-crisis levels: in 2008 they stood at \$181 billion, then dropped to \$95 billion in 2009 before recovering to \$110 billion in 2010. Since then, flows have dropped again to \$83 billion in 2013.¹² Employment by EU affiliates in the US also took a blow, decreasing from 3.5 million in 2008 to 3.3 million in 2009.¹³ The feared spillover of the Euro crisis to the US banking sector did not materialize but the degree of interconnectedness between the US and EU banking sectors has become clear. In fact, while it was clear that the US did not have substantial holdings in the Eurozone's peripheral countries such as Greece, Ireland and Portugal, US banks were exposed to banks in Germany, France and the UK, which in turn were exposed to the periphery. Economic repercussions do not necessarily have to stem from economic developments: gains by populist parties in the EU could lead to a reversal of European integration, leading to a weakening of the European single market and of the transatlantic economy. Political developments in a particular European country can have an effect on the transatlantic economy: for instance the UK's possible exit from the EU could result in a weakening of the Union's attachment to open markets and free trade.

North Carolina is an integral part of the transatlantic economy. In 2013 it exported \$5.7 billion worth of goods to the EU, a figure larger than the \$5.4 billion of 2012.¹⁴ Services exports to the

EU were estimated to be worth another \$4.5 billion, amounting to over a third of all North Carolina's service exports.¹⁵ In terms of jobs, data for the EU as a whole is not available, but nearly 73,000 jobs depend on EU affiliates from Germany, France, the UK, and the Netherlands in 2011.¹⁶ By including Switzerland, which is part of the European single market, this figure rises to 92,000. North Carolina's links to the EU also mean it is vulnerable to economic developments in Europe: goods exports to the EU dropped sharply from \$5.6 billion in 2008 to \$5 billion in 2010. Whereas exports to countries such as Germany recovered rapidly after 2009, exports to countries worse affected by the crisis have not yet recovered. For instance exports to France and Italy declined sharply in 2009, recovered in 2010, but then dropped again in 2011 with the spread of the Euro crisis.¹⁷ Employment by European affiliate firms in North Carolina was also affected by the economic crisis: employment by French affiliate firms dropped by 2600 between 2008 and 2010, employment in UK owned affiliated by 4000 between 2008 and 2009.¹⁸

A Strong Partnership

The US has been one of the strongest advocates of European integration since the start of the process after the Second World War. A strong Europe means a strong partner for America on the global stage. Indeed, Europe matters to America not only because of its economic importance: the EU remains America's most important international partner concerning a host of other issues from international security to global governance. Cooperation is extensive not only because of overlapping interests, but also because of a set of underlying values and historical bonds: both the EU and the US are committed to very similar forms of democracy and rules of law. In the field of security the EU and US co-operate on many different levels: there is near-constant dialogue and cooperation in tackling international terrorism, transnational crime and drug trafficking. More broadly, the EU has increasingly taken on an important role in securing its neighborhood, in particular in the Western Balkans and Africa, but more recently the EU's response to the crisis in the Ukraine has been fitful. In the framework of the Common Security and Defense Policy (CSDP), the EU has launched over 30 missions contributing to conflict prevention, stabilization and peacekeeping. Perhaps the most visible example is the EU's mission to tackle piracy in the Horn of Africa by means of a 'comprehensive approach' aimed at preventing acts of piracy while also increasing local capacity and promoting good governance. Through the CSDP, the EU has also contributed to training troops in several other African countries, and has been extensively involved in peacekeeping in the Balkans, especially in Macedonia and Bosnia. But Europe's contribution to security mostly takes place outside of the CSDP framework: whether under the auspices of the UN or NATO, whether through ISAF in Afghanistan or UNIFIL Lebanon, individual European states have contributed extensively to global stabilization and peacekeeping missions. In particular in Afghanistan European forces contributed thousands of troops over many years. The EU has provided extensive financial contributions in Iraq and Afghanistan, supporting the development of effective governance and the rule of law.

The EU's most important contribution to security so far may well have been that of its own enlargement: the Union's eastward expansion to the former communist states of central and eastern Europe has absorbed many of them in the broader Western community, leading to greater prosperity and security. Closer association with the EU continues to be a strong magnet for many countries from Serbia to Turkey, acting as a stimulus for the deepening of democratic institutions

and for economic reform, and there is a case to be made that bringing Turkey into the EU would have helped to resolve a great number of the security capability problems the EU has faced since 2001 (see complementary brief). The EU's is also a key US partner in international diplomacy. From the Middle East Peace process to the ongoing negotiations over the Iranian nuclear program, the EU and US cooperate closely to achieve enduring solutions. The EU's presence and alignment at the negotiating table enhances legitimacy and often opens up new negotiating options. For instance, if an agreement is reached with Iran, the EU's may well prove essential in order to achieve a gradual removal of sanctions compatible with US and Iranian requirements. The EU has been key in shaping the development of global institutions such as the UN and the WTO. In international institutions and multilateral forums, the EU and US co-operate in striving for a rules-based international order. In terms of trade the EU has always been a key player in pushing for liberalization and a global system of rules. The EU's role in development cooperation is also very important: the Union is the world's largest aid donor, providing development assistance, emergency aid and humanitarian assistance.¹⁹ On the whole, the EU appears to be an irreplaceable partner to the US: sharing the burden of security, enhancing and complementing the efforts of US diplomacy throughout the world and contributing to tackling global challenges.

Future Prospects

Europe still matters for America and there is no sign that this importance is set to decrease in any significant way in the future. In economic terms, it is increasingly possible that the relationship will deepen further as a result of the TTIP currently being negotiated. Negotiations started in July 2013 with the aim of lowering barriers to trade and harmonizing standards. Barriers to trade are already low, with tariffs averaging 4%, but the scale of trade is such that even small reductions can have a significant impact. However, talks are not only focused on reducing tariffs, but also on tackling non-tariff barriers. These are still present in the form of incompatible standards and regulations, and are estimated to be equivalent to additional tariffs worth between 10-20%.²⁰ By opening up markets and forging greater regulatory compatibility, the TTIP has the potential to create jobs and growth on both sides of the Atlantic. The scale of benefits is not yet clear, but different estimates suggest a 0.3% to 0.4% boost for US GDP and 0.5% to 0.7% boost for EU GDP.²¹ It is estimated that an ambitious TTIP could support up to 740,000 new jobs in the US, and that US households stand to gain \$865 annually.²² North Carolina stands to benefit from the TTIP: goods exports to the EU could increase by as much as 30%, and lead to the creation of almost 23,000 new jobs. Benefits of the TTIP would not be limited to the transatlantic economy: it is hoped that the agreement will contribute to the development of a set of global standards in trade. The combined size of the US and EU economies means that others are likely to follow whatever standards the TTIP sets in terms of worker and environmental protection and intellectual property.

Even if TTIP does not materialize in its most ambitious form, it is clear that Europe will continue to remain one of the engines of the global economy, and one of the preferred destinations of American FDI. At the beginning of 2014, Europe's comparative advantages seemed evident once again as Europe slowly emerges from the crisis and the rise of emerging markets seemed markedly less inevitable than just a few years before. The EU is a mature market economy, with millions of wealthy consumers, comparatively excellent infrastructure, an educated workforce,

high worker productivity, and high research and development spending. Perhaps even more importantly, it is seen as a politically stable region, where property and the rule of law are guaranteed. Corporate America's continuing investments in Europe suggest that firms have never overlooked these underlying strengths.

In political terms, Europe is set to remain America's most important partner internationally. High profile disagreements in the past as well as frequent divisions amongst European countries should not conceal the extent of daily co-operation in areas ranging from foreign aid to counterterrorism. In the future it will become increasingly likely that Europeans will develop a more cohesive foreign policy. As European states are confronted by growing instability in Europe's neighborhood and by the reality of the US 'pivot' to Asia, they are also likely to deepen defense cooperation within many different bilateral and multilateral frameworks: recent trends point to a weakening of the EU's own Common Security and Defense Policy, but to a strengthening of NATO. As the Europeans start to act more cohesively on the world stage, Europe's importance to the US is set to endure and possibly even to increase.

Political relations between the EU and the US can at times be somewhat strained. Yet, the transatlantic relationship has proven very resilient. As long as its pillars remain strong, as long as values coincide and economic links remain deep, there is no reason to believe it will weaken.

Written 20 May 2014

¹ According to IMF GDP PPP Data, the EU economy was worth \$16,26 trillion in 2013, the US economy \$16,79 trillion

² BEA, U.S. International Transactions, by Area

³ BEA, U.S. Direct Investment Abroad, All Foreign Affiliates, Total Sales By Country

⁴ Bureau of Economic Analysis (BEA), Foreign Direct Investment in the U.S., All U.S. Affiliates.

⁵ BEA, Foreign Direct Investment in the U.S.: Country and Industry Detail for Financial Inflows.

⁶ BEA, Foreign Direct Investment in the U.S., Majority-Owned Bank and Nonbank U.S. Affiliates, Employment.

⁷ Daniel S. Hamilton and Joseph P. Quinlan, *The Transatlantic Economy 2014*, Johns Hopkins University School for Advanced International Studies, 2014 <http://transatlantic.sais-jhu.edu/transatlantic-topics/transatlantic-economy-series.htm>

⁸ BEA, Foreign Direct Investment in the U.S., Majority-Owned Bank and Nonbank U.S. Affiliates, Research and Development Expenditures.

⁹ BEA U.S. Direct Investment Abroad, All Foreign Affiliates, Total Assets By Country.

¹⁰ BEA, U.S. Direct Investment Abroad, Financial Outflows Without Current-Cost Adjustment

¹¹ BEA, US International Transactions by Area

¹² BEA, Foreign Direct Investment in the U.S.: Country and Industry Detail for Financial Inflows, 2013

¹³ BEA, Foreign Direct Investment in the U.S., All U.S. Affiliates, Employment By Country

¹⁴ Foreign Trade division of US Census Bureau; See also
<http://www.nccommerce.com/Portals/47/Publications/Industry%20Reports/2013%20Annual%20Trade%20Report%20vFINAL.pdf>

¹⁵ *TTIP and the Fifty States: Jobs and Growth from Coast to Coast*, report by the Atlantic Council, the Bertelsmann Foundation and the British Embassy in Washington, September 2013
<https://www.gov.uk/government/publications/ttip-and-the-fifty-states-jobs-and-growth-from-coast-to-coast>

¹⁶ BEA, Foreign Direct Investment in the U.S., Majority-Owned Bank and Nonbank U.S. Affiliates, Employment

¹⁷ US Department Of Commerce, International Trade Administration, North Carolina merchandise exports to the EU.

¹⁸ BEA, Foreign Direct Investment in the U.S., Majority-Owned Bank and Nonbank U.S. Affiliates, Employment by State and Country.

¹⁹ http://europa.eu/pol/dev/index_en.htm

²⁰ http://trade.ec.europa.eu/doclib/docs/2013/march/tradoc_150760.pdf

²¹ *The Transatlantic Economy 2014* estimates a 0.3% boost to US GDP and a 0.7% boost to EU GDP. A study by the Centre for Economic Policy Research estimates a 0.4% boost to US GDP and 0.5% boost to EU GDP. For the CEPR Study see

http://trade.ec.europa.eu/doclib/docs/2013/september/tradoc_151787.pdf

²² *TTIP and the Fifty States: Jobs and Growth from Coast to Coast*