CHAPTER 2

THE POST-CRISIS TRANSATLANTIC ECONOMY: Revisiting the Ties that Bind

Notwithstanding all the chatter about the "Rise of the Rest" and the secular ascent of China, the global economy still rests squarely on the shoulders of the transatlantic economy. No commercial artery is as large as the one binding together the United States and Europe. The transatlantic economy remains the world's largest and wealthiest market, and still accounts for roughly 35% of world GDP in terms of purchasing power parity. It is at the forefront of global R&D, and drives global foreign direct investment and global mergers and acquisitions activity.

Taken together, U.S. and European exports to the world accounted for one-quarter of global exports in 2013, the last year of complete data; combined imports represented nearly 30% of the world total. The true driver of the transatlantic economy, however, is foreign investment, the deepest form of global integration. The transatlantic economy is wound and bound together by symbiotic ties between investment and trade in both goods and services. U.S. and European companies prefer to establish operations and sell goods and provide services within each other's markets — and many others around the word — rather than just send goods across borders. Transatlantic foreign affiliate sales, for instance, topped $5.5 trillion. Meanwhile, the United States and Europe together accounted for 57% of inward stock of FDI and a whopping 70% of outward stock of FDI. Each partner has built up the great majority of that stock in the other economy; in the end, mutual investment in the North Atlantic space is very large and has become essential to jobs and prosperity on each side of the Atlantic.

All told, we estimate that roughly $5.5 trillion in commerce takes place between the United States and Europe each year.

For all of these reasons, the transatlantic economy remains the dominant force in the global economy. Yes, rising markets offer new sources of supply (labor) and demand (consumers) for U.S. and European firms. American and European firms are building out their in-country presence in the developing countries, and for good reason. Growth rates are still above the global average in most of these countries, which are populated with young consumers hungry for Western goods and services. In addition, the technological skill levels of many developing nations are now on par with many developing nations. It makes perfect sense for U.S. and European firms to invest outside the transatlantic economy. There is no doubt that rising powers are resetting the global economy. Yet such a transformation is neither complete nor pre-ordained, as the current slowdown across the emerging market universe indicates.

In general, the "Rise of the Rest" is a healthy dynamic for the global economy. But this dynamic does not signal a retreat on the part of U.S. and European firms from the transatlantic economy. It is more about global rebalancing, with many transatlantic firms working to deepen their footprint in developing countries, replicating the deep ties that are the hallmark of the U.S.-EU relationship. In fact, U.S. and European firms are using global value chains to integrate the value-added other nations can contribute to particular products and services into transatlantic bonds of investment and trade.

Investment Shifts

The United States and Europe remain each other's top investment and trade partner. This basic fact has been clouded over the past year, however, by headline issues ranging from continued drama in the eurozone and high-profile mergers and disinvestments to controversies over tax inversions and possible sweetheart deals for companies. Cutting through the fog means recognizing what remains distinctive about the transatlantic economy, and understanding a number of anomalies that

characterized transatlantic commercial flows in 2014. Let's start with the asterisks.

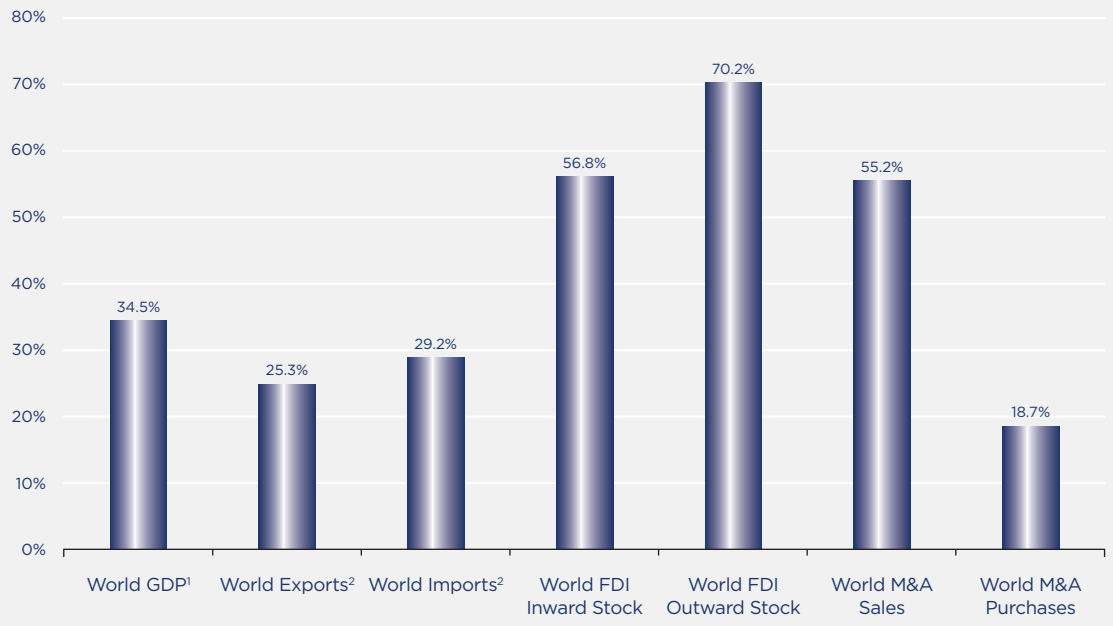
Mutual flows of investment remain the lifeblood of the transatlantic economy. Yet we estimate that foreign direct investment (FDI) flows from Europe into the United States totaled just $15 billion in 2014, one of the smallest figures on record. In the first nine months of 2014, such flows were -$37.7 billion, meaning that more European capital left the United States than came in. These figures, however, were massively skewed by the one-off capital disinvestment event between Vodaphone (UK) and Verizon (U.S.), a deal that saw Vodaphone sell its 45% share in Verizon Wireless to Verizon for $130 billion, leading to a massive -$122 million disinvestment in U.S. inflows in the first quarter of 2014. In the same quarter, Luxembourg also reported a $20.6 billion *dis*investment from the United States, which further depressed overall levels of inflows.

A closer look at the figures reveals that European FDI flows into the United States tallied -$117.1 million in the first quarter of 2014 but then rebounded to $31.3 billion in the second quarter and $48 billion in the third quarter. U.S. FDI inflows from Europe, in other words, normalized over the balance of the year. Indeed, cumulative FDI flows from Europe into the United States in the second and third quarter of 2014 ($79.3 billion) were roughly 27% larger than the same period a year earlier.

Turning to U.S. FDI flows into Europe, another one-off event skewed the 2014 numbers. U.S. FDI flows into Europe totaled $115 billion in the first nine months of 2014, a decline of 19% from the same period a year earlier. But this decline also deserves an asterisk.

In the first quarter of 2014, the Netherlands reported a -$19 billion FDI outflow from the United States. The large recorded outflow reflected the fact that for tax reasons many U.S. firms, rather than repatriate retained earnings to the U.S. for tax reasons, have instead raised funds in Europe and then transferred the proceeds to the United States. This represents a negative intra-company loan, which in turn depresses aggregate U.S. FDI outflows (keep in mind that intra-company loans are a key component of FDI, along with retained earnings and equity from the parent

TABLE 1: THE TRANSATLANTIC ECONOMY VS. THE WORLD - SHARE OF WORLD TOTAL



Sources: UN, IMF, figures for 2013.
1. Based on PPP estimates.
2. Excluding intra-EU, Norway, Switzerland and Iceland trade.

firm). On balance, the large net outflow from the Netherlands overstates the decline in U.S. investment to Europe in 2014.

The -$19 billion FDI outflow from the Netherlands depressed the figures so much that total U.S. outflows to Europe totaled just $9.4 billion in the first quarter. Outflows normalized in the second and third quarters, however, totaling $52.7 billion and $53 billion, respectively. Figures for the third quarter of 2014 were up 13.5% from the prior year. For all of 2014, we estimate that U.S. FDI outflows to Europe totaled $165 billion, a 4.5% decline from 2013.

On balance, there are a lot of moving parts to FDI flows, whether U.S. outflows and inflows. U.S. and European multinationals are still adjusting to the post-crisis climate, resulting in one-off moves in FDI flows. As part of this backdrop, corporate inversions and the role of holding companies have become intense topics of debate. We explore these issues in Chapter Four.

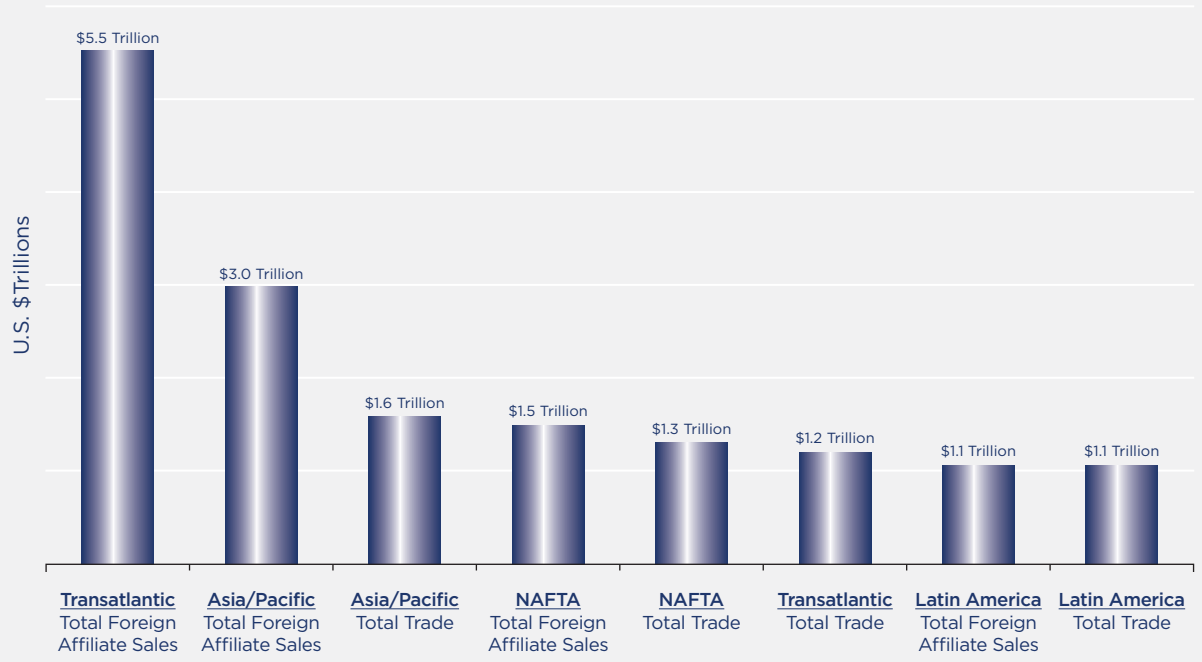
Overall, however, European and American firms still center their global operations on the U.S. and Europe. This becomes clearer by looking at eight different ways in which the U.S. and European economies are bound so tightly together.

The Ties That Bind—Quantifying the Transatlantic Economy

1. Gross Product of Foreign Affiliates

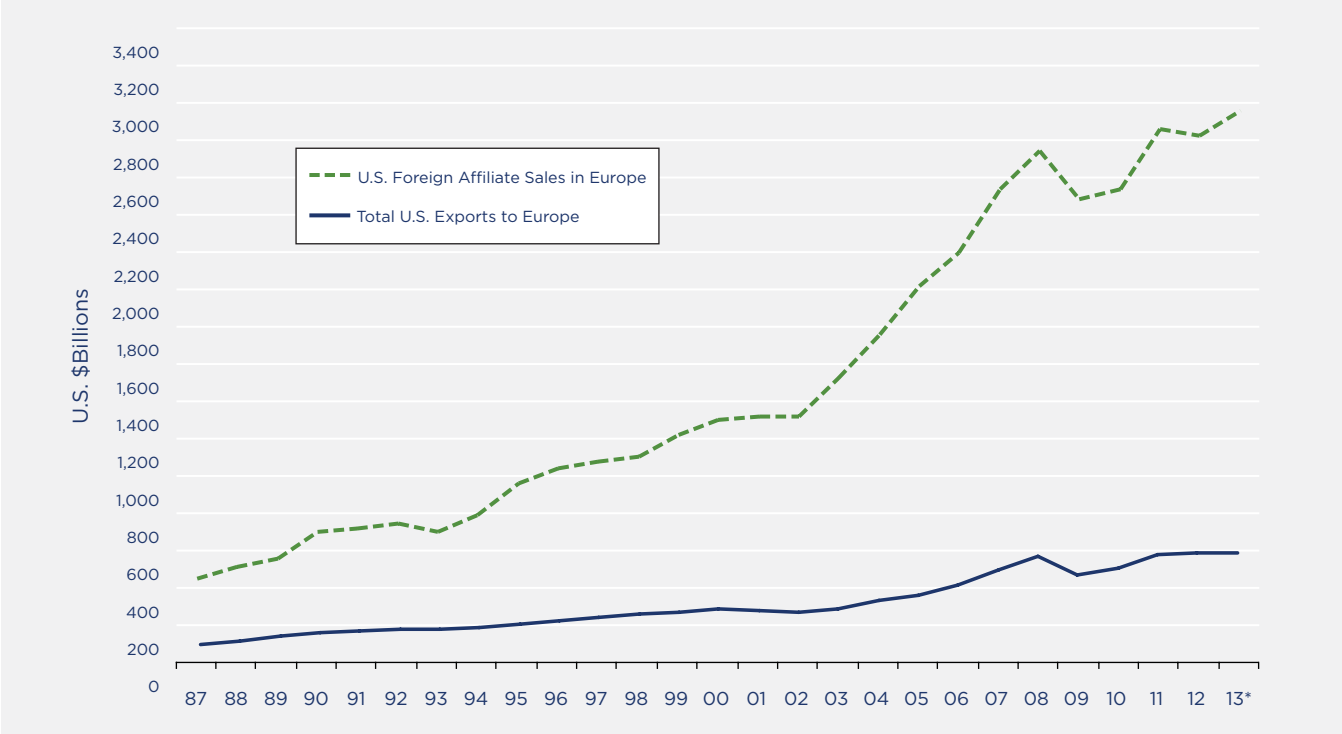
The activities of foreign affiliates are an important glue binding together the United States and Europe. Having constructed a formidable foundation over the past seventy years, they are the foot soldiers of the transatlantic partnership. As standalone entities, U.S. affiliates in Europe and European affiliates in the United States are among the largest and most advanced economic forces in the world. The total output of U.S. foreign affiliates in Europe (an estimated $700 billion in 2013) and of European foreign affiliates in the United States (estimated at $535 billion) was greater than the total gross domestic product of most countries. Combined, transatlantic affiliate output—nearly $1.3 trillion—was larger than the output of such countries as the Netherlands, Turkey or Indonesia.

TABLE 2: AMERICA'S MAJOR COMMERCIAL ARTERIES



Foreign Affiliate Sales: Estimates for 2013. Total Trade: Data for goods & services, 2013.
Source: Bureau of Economic Analysis.

TABLE 3: SALES OF U.S. AFFILIATES IN EUROPE VS. U.S. EXPORTS TO EUROPE



**Estimate for sales.*
Source: Bureau of Economic Analysis.
Majority-owned non-bank affiliates data: 1987 - 2008. Majority-owned bank and non-bank affiliates: 2009 - 2013.

By our estimation, U.S. affiliate output in Europe rose by around 4% in 2013, while European affiliate output in the United States rose by a slightly faster pace of 6%. European affiliate output in the United States has recovered and expanded since falling to a cyclical low of $391 billion in 2009. U.S. affiliate output in Europe has also recovered from its pre-crisis lows.

We expect further gains in U.S. foreign affiliate output in the near term, supported by Europe's improving economic performance over the balance of 2015. European affiliates in the United States, in turn, are operating in one of the most dynamic economies in the world and are expected to boost their near-term output as well.

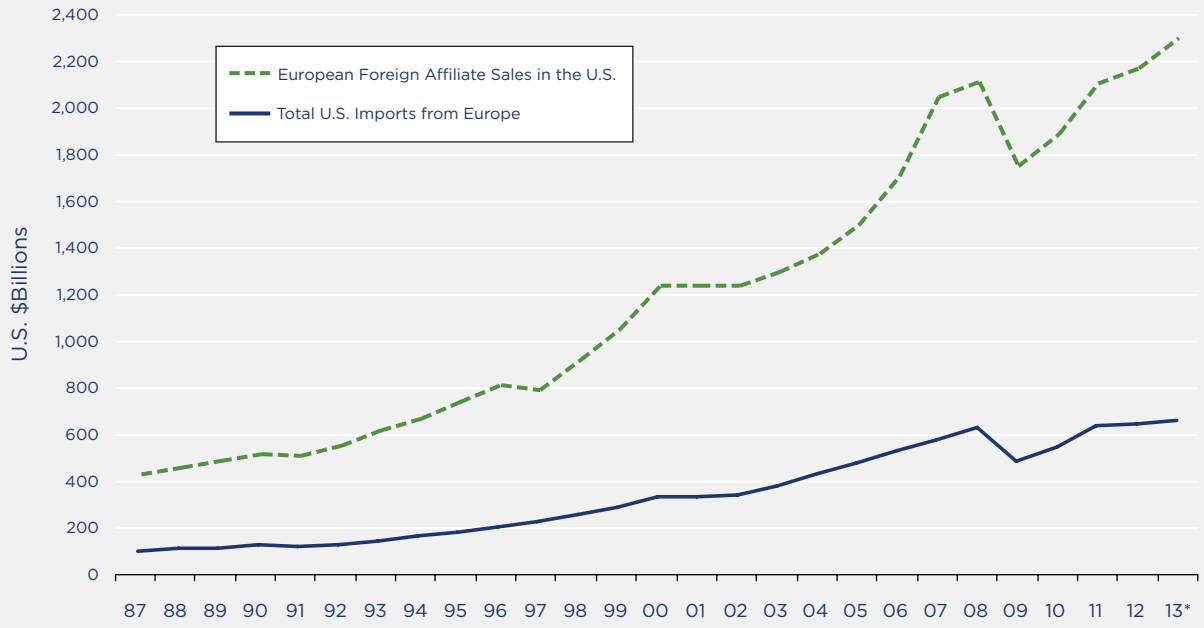
On a global basis, the aggregate output of U.S. foreign affiliates reached $1.5 trillion in 2013, with Europe (broadly defined) accounting for around 46% of the total. The United Kingdom, where U.S. investment ties are deepest, accounted for roughly one-quarter of total affiliate output in Europe in 2013.

Looking at actual figures for 2012 from the Bureau of Economic Analysis, U.S. affiliate output in Europe ($673 billion) was roughly double affiliate output in all of Asia ($337 billion). While affiliate output in places like China ($46.4 billion in 2012) and India ($21 billion) has increased over the past decade, U.S. affiliate output in these two emerging Asian giants pales in comparison to U.S. affiliate output in the United Kingdom ($171 billion), Germany ($87 billion), or even Ireland ($81 billion).

In the United States, meanwhile, European affiliates are major economic producers in their own right, with British firms of notable importance. The output of British companies operating in the United States reached an estimated $145 billion in 2013, more than a quarter of the total output of European companies in the United States. Output from German affiliates operating in the United States totaled $94 billion by our estimates, or roughly 18% of the total.

Beyond Europe, only Canada and Japan have any real economic presence in the United States. Japanese affiliate output totaled nearly $97 billion in 2012, the last year of actual data, while Canadian affiliate output totaled $67 billion. Overall, U.S. affiliates of foreign multinationals contributed roughly $830 billion to U.S. aggregate production in 2013, with European affiliates accounting for nearly two-thirds of the total.

TABLE 4: SALES OF EUROPEAN AFFILIATES IN THE U.S. VS. U.S. IMPORTS FROM EUROPE



**Estimate for sales*
Source: Bureau of Economic Analysis
Majority-owned non-bank affiliates: 1987 - 2006. Majority-owned bank and non-bank affiliates: 2007 - 2013.

2. Assets of Foreign Affiliates

The global footprint of Corporate America and Corporate Europe is second to none, with each party each other's largest foreign investor. According to the latest figures from the Bureau of Economic Analysis, U.S. foreign assets in Europe totaled $13 trillion in 2012, representing roughly 60% of all U.S. foreign assets globally.

We estimate that U.S. foreign assets in Europe in 2013 reached $13.6 trillion, also roughly 60% of the global total. Within the region, the UK accounted for the bulk of U.S. assets — an estimated $5 trillion, or around 22% of the global total.

U.S. assets in the Netherlands (around $2 trillion) were the second largest in Europe in 2013. America's significant presence in the Netherlands reflects its strategic role as an export platform/distribution hub for U.S. firms doing business across the Continent. To this point, more than half of affiliate sales in the Netherlands are for export, namely within the EU.

Meanwhile, America's asset base in Germany ($711 billion in 2012) was roughly one-third larger than its asset base in all of South America. America's asset base in Poland, the Czech Republic and Hungary (roughly $142 billion) was much larger than corporate America's assets in India ($102 billion). America's assets in Ireland ($1.1 trillion in 2012) were much larger than those in Switzerland ($678 billion) about 3 times greater than those in France ($377 billion), and 4.5 times greater than those in China ($263 billion).

Total assets of European affiliates in the United States were valued at roughly $9 trillion in 2013 by our estimates. The United Kingdom ranked first, followed by Germany, Switzerland and France. In 2012, the last year of available data, Europe accounted for two-thirds of all foreign-owned assets in the United States.

3. Affiliate Employment

U.S. and European foreign affiliates are a major source of employment for the general transatlantic workforce. On a global basis, affiliates of both U.S. and European parents employ more workers on the other side of the Atlantic than anywhere else in the world. Most foreign workers on the payrolls of U.S. foreign affiliates are employed in developed — not developing — countries, and most notably in Europe.

U.S. foreign affiliate employment in Europe has increased steadily from 3.7 million workers in 2000 to 4.2 million

workers in 2012, the last year of available data. That represents a 13.5% increase. We estimate that U.S. foreign affiliates directly employed 4.3 million European workers in 2013. While aggregate employment levels continue to rise, manufacturing employment has fallen since 2000. Since the start of the century, U.S affiliate manufacturing employment has dropped from 1.9 million in 2000 to 1.7 million in 2012, a 10.5% drop. The largest employment declines were reported in the United Kingdom, with the total manufacturing work force falling from 431,000 in 2000 to 311,300 in 2012. Employment in France dropped from 249,000 to 199,400, while a decline from 388,000 to 355,000 was reported in Germany between 2000 and 2012. U.S. affiliate manufacturing employment in Poland, however, more than doubled between 2000 and 2012, rising from 51,000 to over 102,000 in 2012.

On a global basis, U.S. majority-owned affiliates (including banks and non-bank) employed roughly 14.5 million workers in 2013, with the bulk of these workers—roughly 35%—toiling in Europe. That share is down from 41% in 2008, with the decline reflecting the cyclical slowdown in Europe over the past few years and the fact that a rising share of U.S. overseas capacity is expanding at a faster pace in the faster-growing emerging markets versus slow-growth developed nations. Another factor at work—more and more U.S. firms are opting to stay home due to competitive wage and energy costs, as opposed to shipping more capacity abroad.

Most European employees of U.S. affiliates live in the UK, Germany and France; meanwhile, U.S. majority-owned firms are on balance hiring more people in services activities than in manufacturing. The latter accounted for just 42% of total U.S. foreign affiliate employment in Europe in 2012. The top industry in terms of manufacturing employment was transportation, with U.S. affiliates employing nearly 373,000 workers, followed by chemicals (261,000). Wholesale employment was among the largest sources of services-related employment, which includes employment in such activities as logistics, trade, insurance and other related functions.

Although services employment among U.S. affiliates has grown at a faster pace than manufacturing employment over the past decade, U.S. affiliates employed more manufacturing workers in Europe in 2012 (1.8 million) than in 1990 (1.6 million). This reflects the EU enlargement process, and hence greater access to more manufacturing workers, and the premium U.S. firms place on highly skilled manufacturing workers, with Europe one of the largest sources of such workers in the world.

While the aggregate number of U.S. manufacturing jobs in Europe has increased over the past decades, the geographic distribution of such jobs has shifted. In general, the shift has been towards low-cost locations like the Czech Republic, Poland and Hungary, at the expense of the UK, Germany and France. The later three nations just mentioned accounted for 67% of total U.S. affiliate manufacturing employment in Europe in 1990. By 2012, however, their collective share had dropped to 48%. The UK took the biggest hit; its share of manufacturing employment accounted for just 17.6% of the total in 2012, versus 29% in 1990. Meanwhile, the combined share of U.S. affiliate manufacturing employment in Poland, the Czech Republic and Hungary jumped from virtually zero to nearly 11% in 2012, indicative of the eastern spread of U.S. European operations.

The manufacturing workforce of U.S. affiliates in Germany totaled 355,000 workers in 2012 — above the number of manufactured workers employed in Brazil by U.S. affiliates (320,000) and India (155,000) yet below the figures of China (588,000).

When it comes to affiliate employment, trends in the United States are similar to those in Europe. In other words, despite stories on the continent about local European companies relocating to lower-cost locales in central Europe and Asia, most foreign workers of European firms are American. Based on the last figures, European majority-owned foreign affiliates directly employed roughly 4 million U.S. workers in 2013—some 345,000 workers less than U.S. affiliates employed in Europe. By our estimates, the top five European employers in the U.S. were firms from the UK (987,000), Germany (645,000), France (545,000), Switzerland (486,000) and the Netherlands (393,000). European firms employed roughly two-thirds of all U.S. workers on the payrolls of majority-owned foreign affiliates in 2013.

According to our estimates, German affiliates created 25,000 new jobs in the United States in 2013, followed by firms from the UK (24,000 new jobs) Netherlands (15,000), France (10,000), Italy (3,000) and Spain (1,600).

In the aggregate, the transatlantic workforce directly employed by U.S. and European foreign affiliates in 2013 was roughly 8.3 million strong, up nearly 4% from the year before. In 2014, modest gains in employment were most likely achieved on both sides of the pond, with employment levels in the United States most likely rising at a faster pace than in Europe. That said, as we have stressed in the past, these figures understate the employment effects of mutual investment flows, since

TABLE 5: THE U.S. - EUROPEAN EMPLOYMENT BALANCE THOUSANDS OF EMPLOYEES, 2013[1]

Country	European Affiliates of U.S. Companies	U.S. Affiliates of European Companies	Employment Balance
Austria	46.8	15.3	-31.6
Belgium	131.0	160.2	29.2
Czech Republic	84.9	0	-84.9
Denmark	34.9	30.1	-4.8
Finland	22.6	27.1	4.5
France	456.4	545.1	88.7
Germany	641.7	645.0	3.3
Greece	17.3	2.2	-15.1
Hungary	63.4	0	-63.4
Ireland	106.5	170.0	69.8
Italy	209.5	134.8	-74.6
Luxembourg	14.0	32.9	18.9
Netherlands	228.0	393.1	165.2
Norway	45.6	8.9	-36.7
Poland	159.7	.9	-158.8
Portugal	29.1	.6	-28.5
Romania	46.1	0	-46.1
Slovakia	38.6	0	-38.6
Slovenia	4.7	0	-4.7
Spain	172.4	72.6	-99.8
Sweden	72.5	192.1	119.6
Switzerland	90.3	486.4	396.1
Turkey	49.4	0	-49.4
United Kingdom	1,273.2	987.0	-286.2
Other	279.9	68.9	- 210.0
Europe	**4,318.5**	**3,973.2**	**-345.2**

Note: Employment balance "+" favors the United States
Source: Bureau of Economic Analysis
1. Estimates
Majority-owned bank and non-bank affiliates

these numbers are limited to direct employment, and do not account for indirect employment effects of nonequity arrangements such as strategic alliances, joint ventures, and other deals. Moreover, foreign employment figures do not include jobs supported by transatlantic trade flows. Trade-related employment is sizable in many U.S. states and in many European countries.

In sum, direct and indirect employment remains quite large. We estimate that the transatlantic workforce numbers some 13-15 million workers. Europe is by far the most important source of "onshored" jobs in America, and the United States is by far the most important source of "onshored" jobs in Europe.

4. Research and Development (R&D) of Foreign Affiliates

The United States and Europe no longer have a monopoly on global R&D. As the globalization of R&D has gathered pace this decade, more and more global R&D expenditures are emanating from China, South Korea, and Japan—or Asia in general. There are no boundaries to innovation thanks to proliferation of the internet and falling global communication costs. Both dynamics have helped to spawn more R&D from rising economies, with South Korea and China emerging leaders.

While governments and corporations are the main drivers of R&D spending, foreign affiliates of multinationals are also in the thick of things. In fact, foreign affiliate R&D has become more prominent over the past decades as firms seek to share development costs, spread risks, and tap into the intellectual talent of other nations. Alliances, cross-licensing of intellectual property, mergers and acquisitions, and other forms of cooperation have become more prevalent characteristics of the transatlantic economy in the past decade. The internet, in particular, has powered greater transatlantic R&D. The complexity of scientific and technological innovation is leading innovators to partner and share costs, find complementary expertise, gain access to different technologies and knowledge quickly, and collaborate as part of "open" innovation networks. Cross-border collaboration with foreign partners can range from a simple one-way transmission of information to highly interactive and formal arrangements. Developing new products, creating new processes, and driving more innovation—all of these activities result from more collaboration between foreign suppliers and U.S. and European firms.

That said, bilateral U.S.-EU flows in R&D are the most intense between any two international partners. In 2012, the last year of available data, U.S. affiliates sunk $26.7 billion on research and development in Europe, down slightly from the prior year. On a global basis, Europe accounted for 60% to total U.S. private sector R&D in 2012. R&D expenditures by U.S. affiliates were greatest in Germany ($8 billion), the United Kingdom ($5.2 billion), Belgium ($2.4 billion), Switzerland ($2.1 billion), France ($2 billion), the Netherlands ($1.5 billion) and Ireland ($1.5 billion). These seven countries accounted for 87% of U.S. corporate global spending on R&D in Europe in 2012.

TABLE 6: THE TOP 20 R&D SPENDERS

		R & D Spending			
2014	**Company**	**2014, $U.S. Billions**	**Change from 2013**	**Headquarters Location**	**Industry**
1	Volkswagen	13.5	18.9%	Germany	Auto
2	Samsung	13.4	28.0%	South Korea	Computing and Electronics
3	Intel	10.6	4.6%	U.S.	Computing and Electronics
4	Microsoft	10.4	6.1%	U.S.	Software and Internet
5	Roche	10.0	–1.8%	Switzerland	Healthcare
6	Novartis	9.9	5.6%	Switzerland	Healthcare
7	Toyota	9.1	–7.0%	Japan	Auto
8	Johnson & Johnson	8.2	6.8%	U.S.	Healthcare
9	Google	8.0	17.1%	U.S.	Software and Internet
10	Merck & Co.	7.5	–8.1%	U.S.	Healthcare
11	General Motors	7.2	–2.3%	U.S.	Auto
12	Daimler	7.0	4.8%	Germany	Auto
13	Pfizer	6.7	–15.1%	U.S.	Healthcare
14	Amazon	6.6	43.8%	U.S.	Software and Internet
15	Ford	6.4	16.4%	U.S.	Auto
16	Sanofi	6.3	0.1%	France	Healthcare
17	Honda	6.3	–6.6%	Japan	Auto
18	IBM	6.2	–1.2%	U.S.	Computing and Electronics
19	GlaxoSmithKline	6.1	–2.4%	United Kingdom	Healthcare
20	Cisco Systems	5.9	8.3%	U.S.	Computing and Electronics
		165.3	**5.4%**		

Source: Strategy&

In the United States, meanwhile, expenditures on R&D performed by majority-owned foreign affiliates totaled $48 billion in 2012, up slightly from the prior year. As in previous years, a sizable share of this R&D spending emanated from world-class leaders from Europe, given their interest in America's highly skilled labor force and world-class university system. Most of this investment took place among European firms in such research-intensive sectors as autos, energy, chemicals, and telecommunications. In 2012, R&D spending by European affiliates totaled $36.8 billion, accounting for 77% of total foreign private sector R&D spending in the United States.

By country, Swiss-owned affiliates were the largest foreign source of private sector R&D in the United States in 2012 and accounted for a quarter of the European total, pumping some $9.4 billion into the U.S. economy. British firms

accounted for the second largest percentage of affiliate expenditures, with a 18.4% share in 2012. Germany and France each accounted for 6%. As Table 6 highlights, some of the world's most innovative companies are domiciled in the U.S. and Europe.

5. Intra-firm Trade of Foreign Affiliates

While cross-border trade is a secondary means of delivery for goods and services across the Atlantic, the modes of delivery—affiliate sales and trade—should not be viewed independently. They are more complements than substitutes, since foreign investment and affiliate sales increasingly drive cross-border trade flows. Indeed, a substantial share of transatlantic trade is considered intra-firm or related-party trade, which is trade that occurs across borders but stays within the ambit of the company. Intra-firm or related party-trade occurs when BMW or Siemens of Germany sends engines and auto components to BMW of South Carolina or Siemens of North Carolina; when Lafarge or Michelin send intermediate components to their plants in the Midwest, or when 3M ships components from its office products or communications sectors from St Paul to affiliates in Germany or the UK.

The tight linkages between European parent companies and their U.S. affiliates are reflected in the fact that roughly 61% of U.S. imports from the European Union consisted of related-party trade in 2013. That is much higher than the related party imports from the Pacific Rim nations (around 43%) and South/Central America (39%) and well above the global average (50%). The percentage was even higher in the case of Ireland (91.5%) and Germany (69.2%).

Meanwhile, roughly one-third of U.S. exports to Europe in 2013 represented related-party trade, but the percentage is much higher for some countries. For instance, almost half of total U.S. exports to Belgium (49%) and the Netherlands (46%) was classified as related-party trade. The comparable figure was 32% for Germany and 26% for the United Kingdom.

6. Foreign Affiliate Sales

U.S. majority-owned foreign affiliate sales on a global basis (goods and services) totaled an estimated $6.2 trillion in 2013, having rebounded from the decline in 2009 caused by the global recession. Total U.S. exports, in contrast, were $2.3 trillion in 2013, or roughly one-third of foreign affiliate sales. This gap underscores the primacy of foreign affiliate sales over U.S. exports. As we have noted many times before, one of the best kept secrets in Washington is how U.S. firms actually deliver goods and services to foreign customers.

TABLE 7: RELATED PARTY TRADE, 2013

	US Imports: "Related Party Trade," as % of Total	US Exports: "Related Party Trade," as % of Total
European Union	60.7	31.9
Germany	69.2	31.6
France	49.3	29.1
Ireland	91.5	35.2
Netherlands	62.6	45.5
United Kingdom	53.6	25.7

Source: U.S. Census Bureau

As usual Europe accounted for the bulk of U.S. affiliate sales in 2013. We estimate that U.S. foreign affiliate sales in Europe topped $2.9 trillion, up 5% from the prior year. U.S. affiliate sales in Europe, by our estimates, amounted to 47% of the global total.

Reflecting the primacy of Europe when it comes to US foreign affiliate sales, sales of U.S. affiliates in Europe were almost double the comparable figures for the entire Asian region in 2012, the last year of available data. Affiliate sales in the UK ($659 billion) were almost double total sales in South America. Sales in Germany ($331 billion) were two-thirds larger than combined sales in Africa and the Middle East. While U.S. sales in China have soared over the past decade, they have done so from a low base, and still remain below comparable sales in Europe. For instance, U.S. affiliate sales of $234 billion in China in 2012 were below those in Ireland ($321 billion) and Switzerland ($293 billion).

Affiliate sales are also the primary means by which European firms deliver goods and services to customers in the United States. In 2013, for instance, we estimate that majority-owned European affiliate sales in the United States ($2.3 trillion) were more than triple U.S. imports from Europe. Affiliate sales rose by 6.5% by our estimates. By country, sales of British firms were the largest ($610 billion), followed by Germany ($446 billion), and the Netherlands ($266 billion). For virtually all countries in Europe, foreign affiliate sales were easily in excess of their U.S. imports in 2013.

7. Foreign Affiliate Profits

Transatlantic profits have rebounded from the depressed levels of 2009, when the global financial crisis and ensuing recession triggered a sharp downturn in affiliate income/earnings on both sides of the pond. In 2014, however, the picture was mixed—U.S. affiliate income in Europe rose nicely, by 6.2%, to $238 billion. That is a record high and

comes against a very challenging backdrop in recession-weary Europe. The figure for 2014 was one-third larger than the depressed levels of 2009, when affiliate income earned in Europe plunged to $179 billion. Meanwhile, European affiliate income earned in the United States dropped slightly last year.

Sluggish growth in Europe, along with the weak euro against the U.S. dollar, makes for a challenging earnings backdrop for U.S. foreign affiliates in Europe over the near term. That said, the region still accounts for the bulk of U.S. global foreign affiliate income, with the region accounting for roughly 53% of global income in the first nine months of last year. Europe, in other words, remains a very important market to U.S. multinationals. As a footnote, we define Europe here in very board terms, including not only the EU28 but also Norway, Switzerland, Russia and smaller markets in central and eastern Europe.

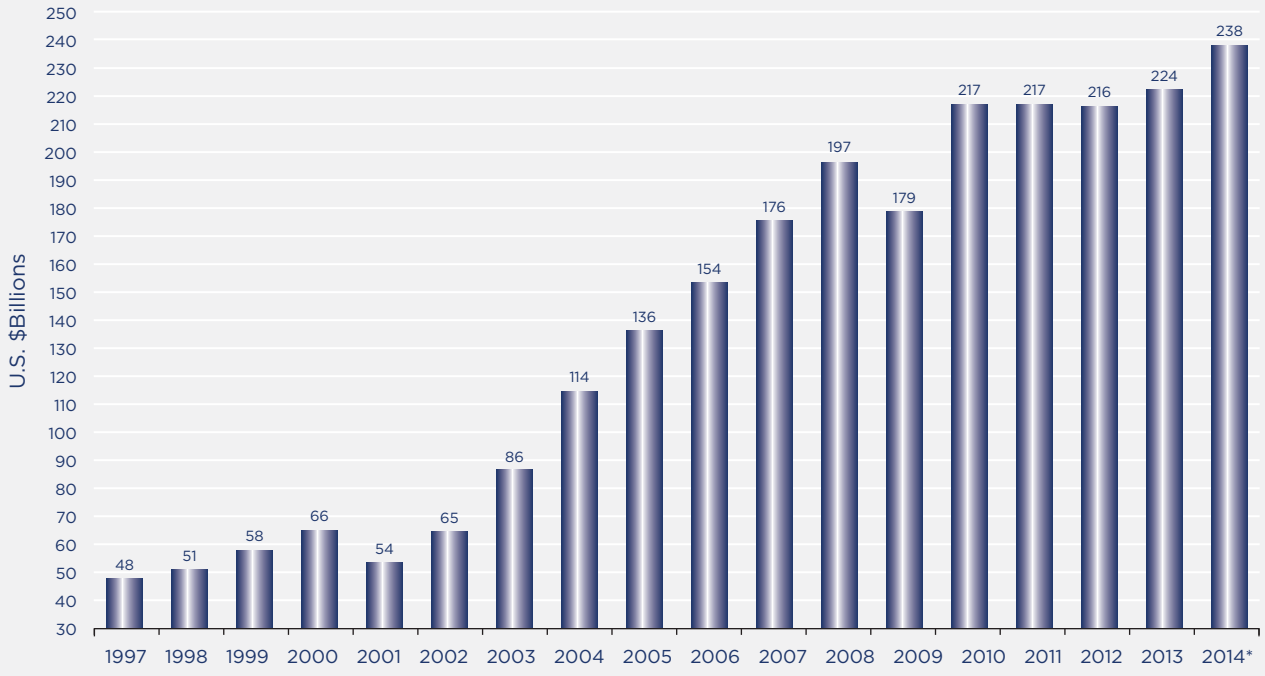
On comparative basis, U.S. affiliate income from Europe is simply staggering, with foreign affiliate income in Europe of $178 billion in the first nine months of 2014 more than the combined affiliate income of Latin America ($61 billion) and Asia ($56 billion). It is interesting to note that combined U.S. affiliate income from China and India in 2013 ($12 billion), the last year of full data, was only around 16% of what U.S. affiliates earned/reported in the Netherlands and a fraction of U.S. earnings in such countries as the United Kingdom and Ireland.

Still, there is little doubt that the likes of China, India and Brazil are becoming more important earnings engines for U.S. firms. To this point, in the first nine months of 2014, U.S. affiliate income in China alone ($7.7 billion) was well in excess of affiliate income in Germany ($2.7 billion), France ($3.5 billion), and Spain ($1.7 billion). U.S. affiliates in Brazil earned nearly $3.4 billion in the January-September period, less than the same period a year earlier but well more than that earned in many European countries.

All that said, we see rising U.S. affiliate earnings from the emerging markets as a complement, not a substitute, to earnings from Europe. The latter very much remains a key source of prosperity for corporate America.

Similarly, the United States remains the most important market in the world in terms of earnings for many European firms. Profits of European affiliates in the United States plunged 21.3% in 2009 before rebounding

TABLE 8: U.S. EARNINGS FROM EUROPE HITTING NEW HIGHS (U.S. FOREIGN AFFILIATE INCOME FROM EUROPE)



Source: Bureau of Economic Analysis
** Data through 3Q2014. Data annualized for full year estimate*

in 2010 and 2011. In 2013, affiliate income fell to $116 billion, a near 5% drop from the prior year. By our estimation, profits were down again in 2014, with European foreign affiliate income estimated at $110 billion, a 5.2% decline from the prior year. In the first nine months of 2014, the income of European affiliates in the U.S. dropped 5.4% from the same period a year earlier. Some of this decline reflects the stronger euro over part of the year and the ongoing consolidation of many European operations in the United States.

8. Transatlantic Services Linkages

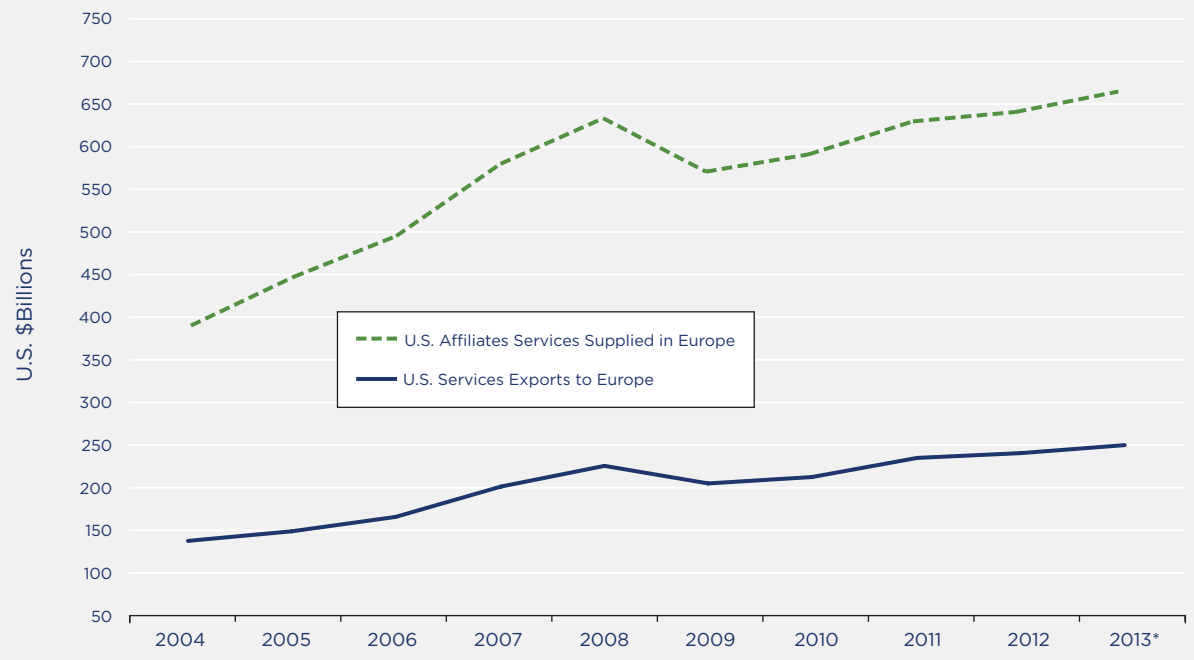
Services remain the sleeping giant of the transatlantic economy, and a key area offering significant opportunities for stronger and deeper transatlantic linkages.[1]

That said, transatlantic ties in services—both in trade and investment—are already quite large. Indeed, the services economies of the United States and Europe have become even more intertwined over the past decade, with cross-border trade in services and foreign affiliate sales of services continuing to expand in the post-crisis environment. By sectors, transatlantic linkages continue to deepen in insurance, education, telecommunications, transport, utilities, advertising and computer services. Other sectors such as aviation, e-health and e-commerce are slowly being liberalized and deregulated.

On a regional basis, Europe accounted for 36% of total U.S. services exports and for 40% of total U.S. services imports in 2013. Four out of the top ten export markets for U.S. services in 2013 were in Europe. The UK ranked second, Ireland fifth, Germany seventh, and Switzerland eighth. Of the top ten services providers to the United States in 2013, five were European states, with the UK ranked first, Germany second, Switzerland sixth, France ninth, and Ireland tenth. The United States enjoyed a $64 billion trade surplus in services with Europe in 2013, versus a $134 billion trade deficit in goods with Europe.

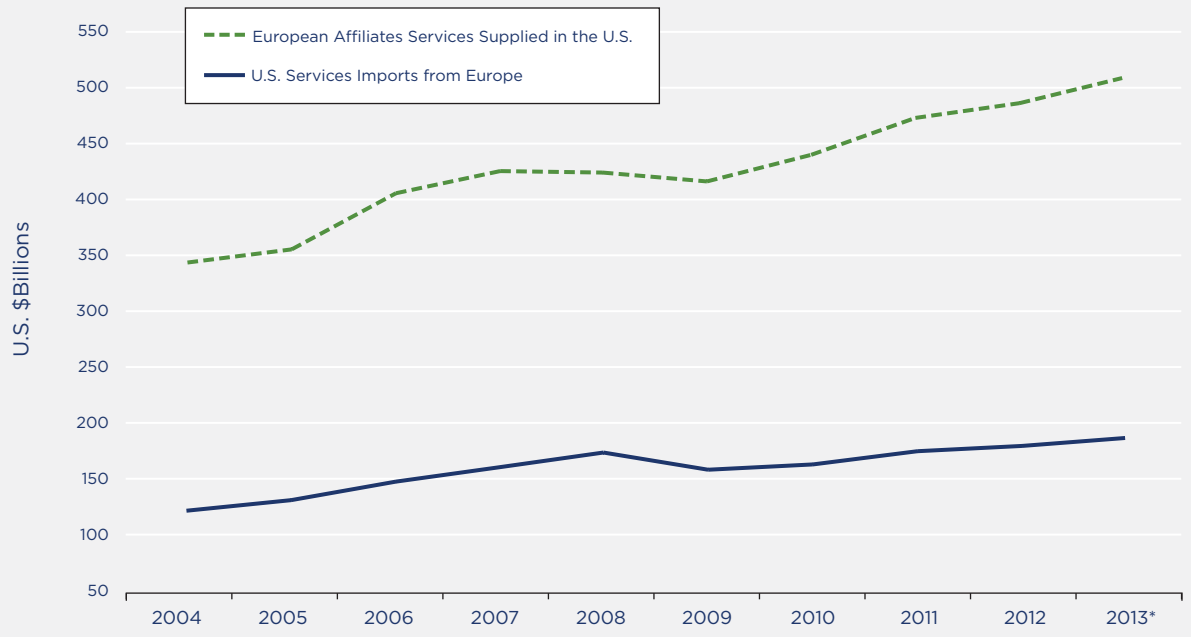
U.S. services exports to Europe reached a record $250 billion in 2013, up 22% from the cyclical slows of 2009, when exports to Europe plunged 9.3%. Services exports (or receipts) have been fueled by a number of services-related activities like travel, passenger fares, education and financial services. In terms of transport, the top five export markets in 2013, ranking order, were Japan, Canada,

TABLE 9: U.S. - EUROPE SERVICES LINKAGES



Source: Bureau of Economic Analysis
Majority-owned bank and non-bank affiliates. Services Supplied in Europe estimate for 2013.

TABLE 10: EUROPE - U.S. SERVICES LINKAGES



Source: Bureau of Economic Analysis
Majority-owned bank and non-bank affiliates. Services Supplied in the U.S. estimate for 2012.

the UK, Germany and China. The UK ranked as one of the largest markets for exports of insurance services; the UK and Belgium-Luxembourg also ranked in the top five in financial services. Ireland was the top export market for U.S. trade in intellectual property—or charges or fees for the use of intellectual property rights. The UK ranked number one in telecommunications, computer and information services. As for "other business service exports" or activities like management consulting and R&D, Ireland ranked number one in 2013, followed by the UK and Switzerland. In Chapter Four we explore why.

As for U.S. services imports from Europe, figures for 2013 were at all time highs. U.S. services imports from Europe totaled $186 billion, up 21.6% from the depressed levels of 2009. The UK, Germany, Ireland, Switzerland, France and Italy all rank as top services exporters to the United States.

Beyond services trade, there are the activities of foreign affiliates, with transatlantic foreign affiliate sales of services much deeper and thicker than traditional trade figures suggest. Indeed, sales of affiliates have exploded on both sides of the Atlantic over the past few decades thanks to the falling communication costs and the proliferation of the internet. Affiliate sales of services have not only supplemented trade in services but also become the overwhelming mode of delivery in a rather short period of time. Affiliates sales of U.S. services rose more than 10-fold between 1990 and 2012, exceeding $1 trillion for the first time in 2007. In 2012, the last year of full data, U.S. affiliate services sales ($1.3 trillion) were roughly double the level of U.S. services exports ($655 billion).

TABLE 11: AMERICA'S FDI ROOTS IN EUROPE (BILLIONS OF $)

Industry	US FDI to Europe	% of Industry Total
European Total	2,607	56%
Manufacturing	298	49%

TABLE 12: EUROPE'S FDI ROOTS IN THE US (BILLIONS OF $)

Industry	US FDI from Europe	% of Industry Total
Total from Europe	1,934	70%
Manufacturing	727	78%

Note: Historic-cost basis, 2013
Source: Bureau of Economic Analysis

Sales of services of U.S. foreign affiliates in Europe have increased each year since plunging in 2009 on account of the transatlantic recession. Sales rose to $641 billion in 2012, up 12.2% from the depressed levels of 2009. U.S. services exports to Europe in the same year totaled $241 billion, well below sales of services by affiliates. In other words, like goods, U.S. firms primarily delivery services in Europe (and vice versa) via their foreign affiliates. The UK accounted for just over 30% of all U.S. affiliate sales in Europe; affiliate sales totaled $195 billion, a figure greater than total affiliate sales in South and Central America ($120 billion), Africa and the Middle East (each $16 billion). Affiliate sales in Ireland remain quite large—$83 billion—and reflect strong U.S.-Irish foreign investment ties with leading U.S. internet, software and social media leaders. On a global basis, Europe accounted for 50% of total U.S. affiliate services sales.

We estimate that sales of services by U.S. affiliates in Europe rose by around 3.5%, to $665 billion in 2013, over 2.6 times the value of U.S. services exports to Europe of $250 billion. U.S. affiliate sales in services in Europe continue to exceed sales of services by U.S. affiliates of European firms. In 2012, the last year of complete data, European affiliate services sales in the United States totaled $490 billion, over 30% below comparable sales of US affiliates in Europe. That said, European affiliates are the key provider of affiliate services in the United States. Foreign affiliate sales of services in the United States totaled $802 billion in 2012, with European firms accounting for 61% of the total. By country, German affiliates led in terms of affiliate sales of services ($117 billion), followed closely by UK affiliates ($116 billion).

We estimate that the services sales of European companies operating in the United States totaled $512 billion in 2013, 2.75 times more than European services exports to the United States ($186 billion). The difference between affiliate sales and service imports reflects the ever-widening presence of European services leaders in the U.S. economy.

In the end, the U.S. and Europe each owe a good part of their competitive position in services globally to deep transatlantic connections in services industries provided by mutual investment flows. A good share of U.S. services exports to the world are generated by European companies based in the U.S., just as a good share of European services exports to the world are generated by U.S. companies based in Europe.

Taken together, these eight indices convey a more complex and complete picture of U.S.-European engagement than mere trade data might suggest. Transatlantic trade in goods is significant in its own right. But foreign direct investment and foreign affiliate sales of both goods and services, not trade, represent the backbone of the transatlantic economy.

Endnotes

1. See Daniel S. Hamilton and Joseph Quinlan, eds., *Sleeping Giant: Awakening the Transatlantic Services Economy* (Washington, DC: Center for Transatlantic Relations, 2007).