CHAPTER 2

ALTERNATIVE FACT: Despite the Turmoil, the Transatlantic Economy is Picking Up Steam

Populist anger on both sides of the Atlantic has uprooted the political establishment of the transatlantic economy. The common denominator is a fierce desire to upend the status quo, to proclaim that "business as usual" just does not cut it anymore. Ironically, these populist leaders have had the most influence in the two countries most often referenced as the standard bearers of open and free trade and investment, and the advocates of the primacy of the free markets—the United States and the United Kingdom. With elections scheduled in the Netherlands, France and Germany this year, the populist wave could spread to other parts of the transatlantic partnership.

It is too early to proclaim that the present era of globalization is over. Retreating yes, but to what extent remains uncertain. More certain is this: globalization—or unfettered cross-border flows of goods, services, people, and data—is not a given any more. Not in a world of rampant political populism-cum-nationalism. A frustrated and moody global electorate has become less supportive and more hostile towards open borders, posing key risks notably to the global architects, champions and primary beneficiaries of the international liberal economic order of the past seven decades: the United States and Europe.

Simply put, without access to each other's resources, many American and European firms would be a fraction of themselves in terms of market capitalization and earnings. The same holds true for many transatlantic economies, and their shareholders.

Take the United States, for instance. Supported by globalization, the U.S. economy has roughly tripled in size since 1990, while manufacturing output has doubled; meanwhile, U.S. exports of goods and services have increased nearly five-fold over the past quarter century. By most metrics, the U.S. has flourished in the age of globalization.

So too has Europe. Open borders and the free movement of goods, labor, and capital have helped to boost growth and prosperity across the continent with a few exceptions. The enlargement process has been largely successful, bringing more and more countries into the European Union and its Single Market, now one of the largest and wealthiest economic entities in the world.

That's not to say that there are not serious flaws to globalization. Widening income inequality, stubbornly high unemployment levels, stagnant wages due to technological advances, fears over immigration—all of these factors have combined to swell the level of economic insecurity in the transatlantic partnership and opened the door for more populist, nationalist politicians. The simple fact that greater cross-border connectivity has made the transatlantic economy larger, more competitive, and wealthier, while boosting the fortunes of stakeholders on both sides of the Atlantic, has all but been forgotten in the alarming and blunt narrative of today.

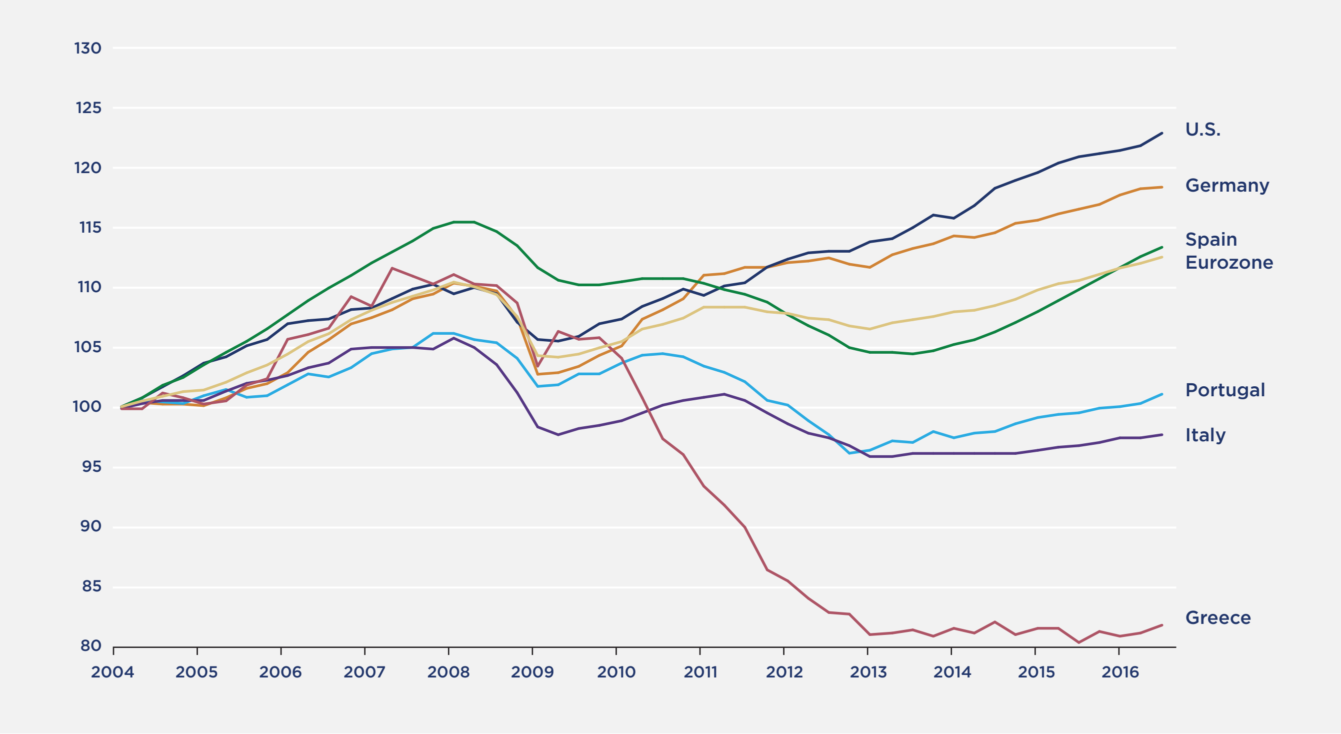
A Good News Story in a Bad News Environment

Ironically, lost in the political earthquakes of the past year is the counterintuitive reality that the economic prospects for the United States, Europe, and the transatlantic economy overall are improving.

In the United States, one of the longest economic expansions in modern history continues, with the economy expanding by 1.6% for calendar year 2016. The U.S. economy is more than 10% larger than when it emerged from recession in June 2009, while the jobless rate has been cut in half since piercing 10% in 2009.

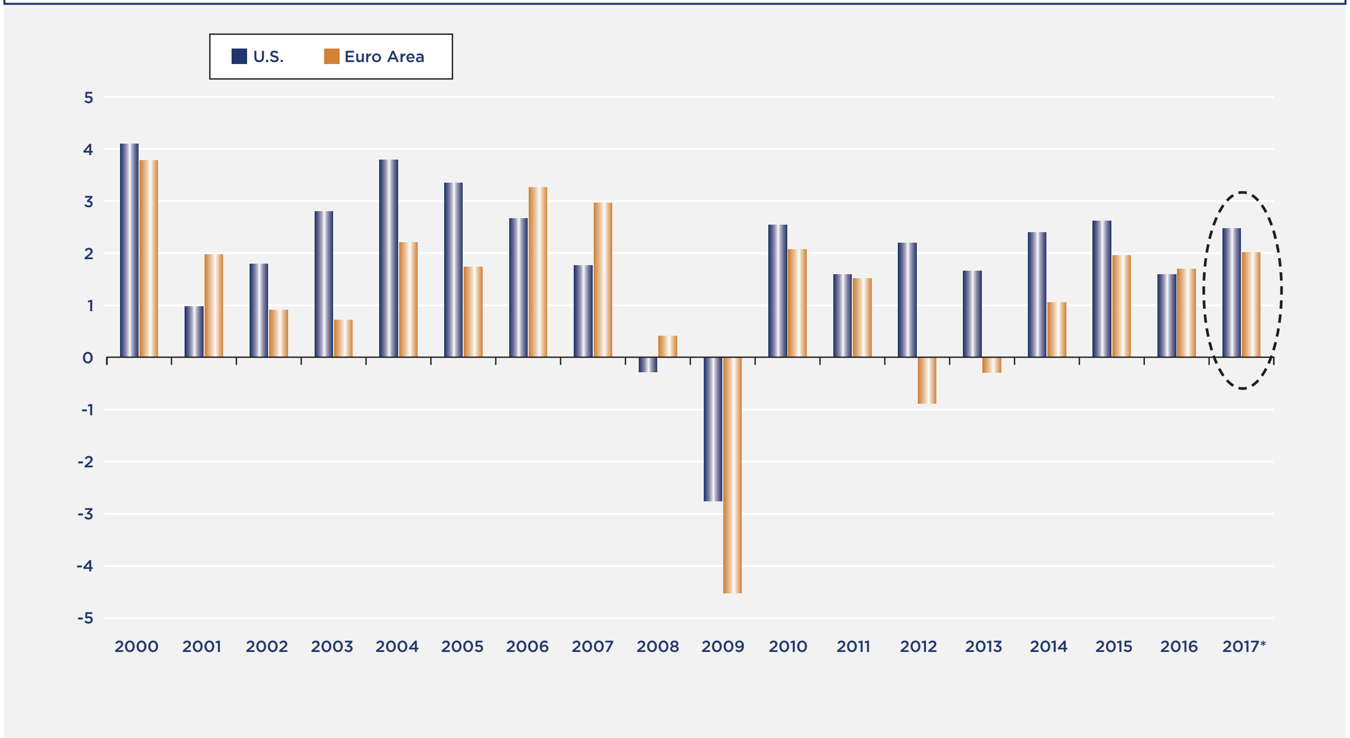
Output across Europe has climbed as well since the crisis, with some notable exceptions, like Greece, mired in recession. In general, Europe ended 2016 on an economic strong note. For 2016 as a whole, growth in the eurozone

TABLE 1: DEVELOPED ECONOMIES BACK ABOVE PRE-RECESSION OUTPUT LEVELS (REAL GDP LEVEL, Q1 2004 = 100)



Source: Haver Analytics.
Data through Q3 2016.

TABLE 2: U.S. VS. EURO AREA - (REAL GDP, ANNUAL PERCENT CHANGE)



**2017 forecast.*
Data as of February 2017.
Sources: IMF; Financial Times; Center for Transatlantic Relations.

reached 1.7%, slightly outpacing the 1.6% registered by the United States.[1] Initial estimates show the German economy expanding by 1.8% last year, with the United Kingdom (2%), Spain (3.2%) and the Netherlands (2.1%) posting even stronger levels of growth than either the United States or Germany.

Meanwhile, unemployment rates have declined across most of Europe for the past year, with eurozone unemployment dropping below 10%, to 9.8%. That is still high, but a huge improvement from the much higher rates of the post-crisis era. Job creation for the eurozone accelerated to a near nine-year record in January 2017, while the rate of output growth maintained a five and a half-year high.

In fact, despite considerable turbulence, including uncertainties generated by Brexit, the eurozone economy is proving resilient. It has registered 14 consecutive quarters of growth through 2016 and business confidence at the turn of 2017 was at its highest level in six years.

Given all of the above, the transatlantic gaps in growth and employment we highlighted last year have all narrowed in the past year. So too has the U.S.-EU trade gap. After widening six years in a row, the U.S. merchandise trade deficit with the European Union declined by $9 billion last year to $146 billion. U.S. exports remained relatively flat at $270 billion, while U.S. imports slipped 3%, totaling $417 billion. The upshot: a 6% decline in the merchandise trade deficit with the EU, the first decline of the post-crisis era.

Most of the decline in the U.S. trade deficit in 2016 was driven by a shift in the composition of trade between America and two of Europe's largest export markets: the United Kingdom and Germany. These nations were among the top destinations for U.S. goods exports, with the United States exporting $55 billion to the UK and $49 billion to Germany in 2016. Likewise, U.S. imports from these two countries were the largest of the EU, and have in recent years exceeded the value of U.S. exports. However, over the past year the U.S. deficit with Germany declined by about $10 billion to $65 billion, while the trade balance with the UK swung from a deficit in 2015 to a surplus in 2016.

Other notable exporters include France and Ireland, each exporting over $45 billion worth of goods to the United States last year. However, while Ireland continues to be a top European exporting nation to the United States, U.S. exports to Ireland are relatively small, registering at just $9.6 billion in 2016. This reflects the significant presence of U.S. multinational companies with operations in Ireland, boosting affiliate sales in Ireland. In 2016 the U.S. trade deficit with Ireland increased by about 18%, with the U.S. importing $36 billion more goods from Ireland than it exported.

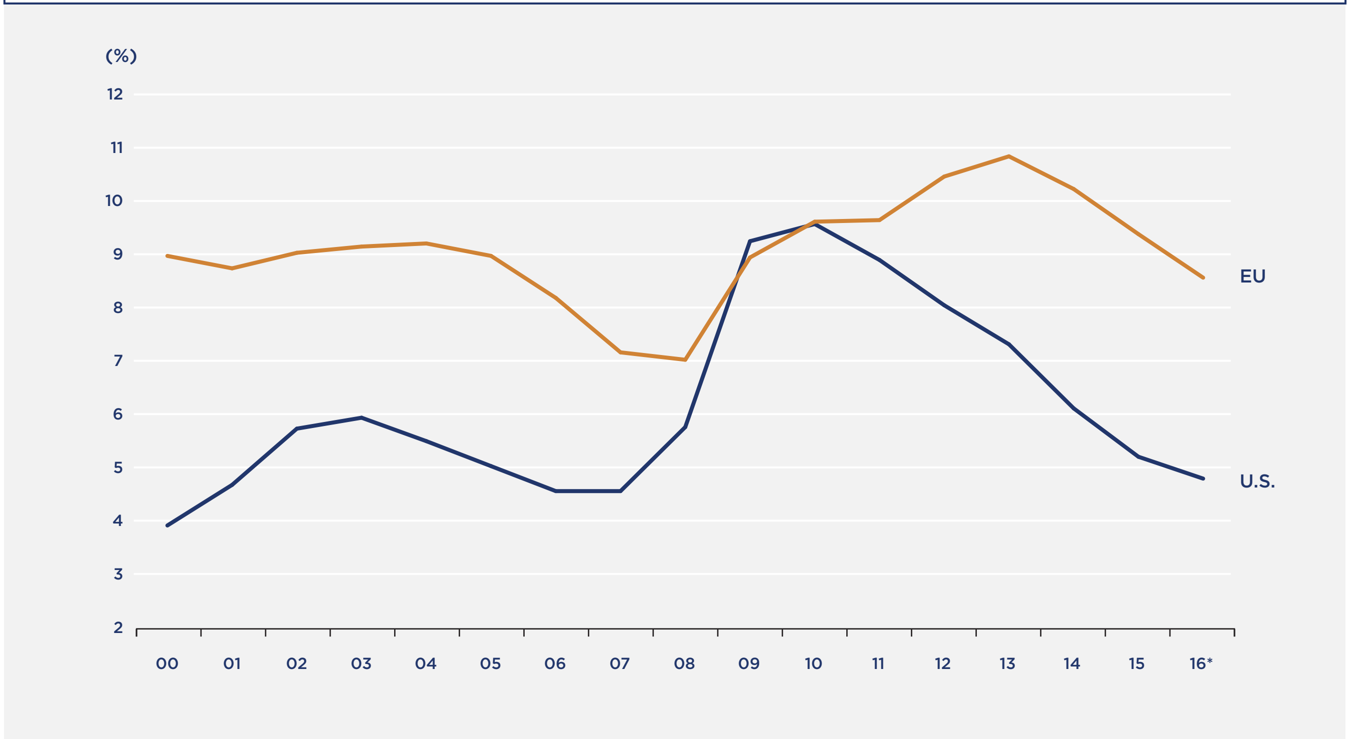
Transatlantic trade still stands as the largest trading relationship, even when compared to America's trade ties with China. Based on the latest available data, both U.S. imports and exports from Europe comprised about 22% of U.S. global trade totals. Meanwhile, Sino-American trade relations are heavily skewed, favoring a Chinese trade surplus, as U.S. imports from China represent 21% of America's total global imports, but U.S. exports to China are only 8% of the global total.

In the end, eight years after the global economic meltdown of 2008-09 the transatlantic economy is gradually healing, albeit slowly. There is still a great deal of work to be done, notably in the face of rising protectionism on both sides of the Atlantic. That said, the transatlantic economy in 2017 remains the largest and wealthiest of the global economy, and home to the largest skilled labor force in the world.

Endnotes

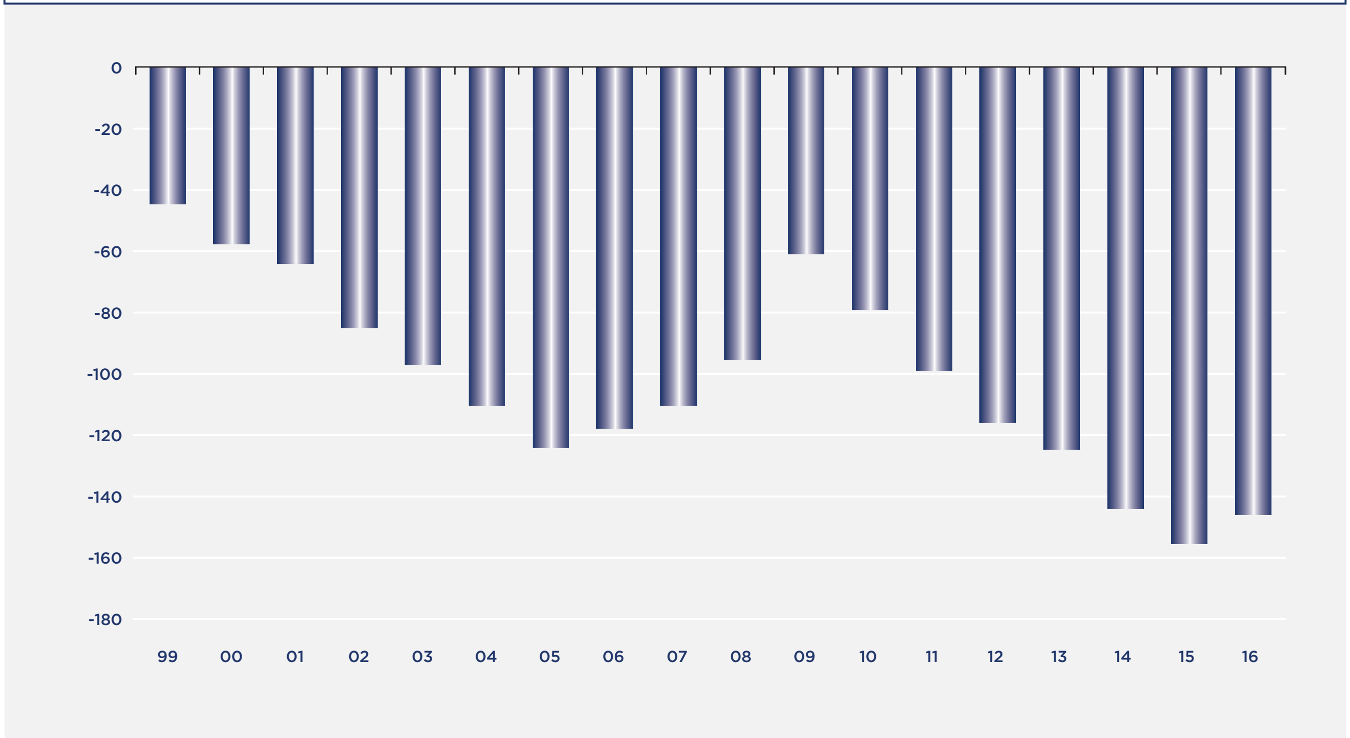
1. Chris Giles, "Eurozone economy quietly outshines the US," *Financial Times*, February 6, 2017.

TABLE 3: U.S. VS. EU UNEMPLOYMENT RATE



**EU average monthly employment rate through November 2016. U.S. data for full year 2016.*
Source: OECD.

TABLE 4: U.S. MERCHANDISE TRADE BALANCE WITH THE EU - (BILLIONS OF $)



Source: United States Census Bureau.