

EUROPEAN COUNTRIES

U.S.-Related Jobs, Trade and Investment

The unity and cohesion of the European Union are under severe strain, with the June 2016 vote by the British to exit the European Union shaking the very foundations of one of the most important economic entities in the world. More political ruptures could be ahead, with populist candidates gaining ground in key countries slated for elections in 2017 — the Netherlands, France and Germany. Add the ongoing economic stress in Greece and Italy, fears of terrorism across the continent, the Middle East/Africa refugee crisis, tensions and sanctions on Russia over its aggression in Ukraine, and the cold shoulder Donald Trump has given European unity, and you have all the ingredients for a real European stew. Never in the past few decades has the transatlantic partnership rested on such a tender underpinning.

These are trying and historic times for Europe. But the latest economic figures underscore corporate America's enduring commitment to its long-standing transatlantic partner. Europe remains one of the most attractive regions of the world for U.S. foreign investment (FDI).

We estimate that U.S. FDI outflows to Europe in 2016 totaled \$220 billion, a 12% rise from the levels of 2015 (\$196 billion). Since hitting a post-crisis peak of \$235 billion in 2011, U.S. FDI outflows to Europe have increased every year since 2014. On a global basis, U.S. FDI outflows in 2016 rose by just over 4%, totaling an estimated \$316 billion for the year. The upshot: Europe accounted for a larger global share of U.S. FDI outflows in 2016—or nearly 70% of the total, up from 65% in 2015. The Asia-Pacific region represented just 21% of the total, underscoring the bias and preference among U.S. firms for Europe versus Asia.

While Europe remains the top destination for U.S. foreign investment, the headline figures don't tell the whole story. In a nutshell, U.S. investment in Europe—for a variety of reasons, ranging from the cost of labor to country-specific tax rates—is becoming more concentrated, with firms

doing more activities in less locations across the region. In the first nine months of 2016, five nations accounted for nearly 95% of total U.S. FDI outflows of \$162 billion to Europe. The five nations in ranked order: the Netherlands, attracting \$42.1 billion and 26.0% of total flows to Europe; the United Kingdom (\$35.1 billion and 21.6% of the total); Ireland (\$31.3 billion and 19.3%), Luxembourg (\$29.7 billion and 18.3%); and Switzerland (\$15.6 billion and 9.6%). In 2015, these five nations also accounted for over 90% of total U.S. FDI outflows to Europe.

U.S. investment flows to the Netherlands were down 5.5% in the first nine months of 2016 from the same period a year ago. Despite this modest decline, the Netherlands, acting as a strategic bridge to the European hinterland and a favorable tax regime, remains a perennial favorite among U.S. multinationals. The United Kingdom is another favorite destination of U.S. firms, with U.S. flows to the UK rising by nearly 30% in the first nine months of 2016. The numbers are inflated by a one-time surge in inflows in the second quarter (\$25 billion), with third quarter figures less than \$5 billion. That said, it is still too early to assess the results of “Brexit,” a topic covered in greater detail in Chapter 1. Total flows to Luxembourg bounced back sharply in 2016, with inflows from the U.S. from January–September 2016 nearly 185% larger than inflows during the same period the prior year.

Ireland and Switzerland remained favored locations for multinationals in 2016, with flows to Ireland rising by nearly 7% in January–September 2016 from the corresponding period a year ago. Over this period, Ireland attracted more U.S. FDI, save the Netherlands and the United Kingdom, than any other nation in Europe, a dynamic that reflects a number of variables, including Ireland's flexible and skilled English-speaking labor force, membership in the European Union, low corporate tax rates, and pro-business policies. Add in Ireland's economic rebound, with the nation among the fastest-growing economies in the world,

TABLE 1: U.S. FDI IN EUROPE: THE LONG VIEW (MILLIONS OF \$, (-) INFLOWS)

	1990-1999		2000-2009		2010-3Q2016	
	\$ Aggregate Total	% of Total	\$ Aggregate Total	% of Total	\$ Aggregate Total	% of Total
EUROPE	465,337		1,149,810		1,244,404	
Austria	2,908	0.6%	501	0.0%	9,228	0.7%
Belgium	12,028	2.6%	40,120	3.5%	11,131	0.9%
Czech Republic	155	0.0%	1,941	0.2%	2,560	0.2%
Denmark	2,798	0.6%	5,782	0.5%	12,643	1.0%
Finland	1,485	0.3%	1,598	0.1%	-1,516	-0.1%
France	29,063	6.2%	42,963	3.7%	14,978	1.2%
Germany	31,817	6.8%	60,363	5.2%	19,408	1.6%
Greece	413	0.1%	943	0.1%	-784	-0.1%
Hungary	2,929	0.6%	1,376	0.1%	-249	0.0%
Ireland	21,369	4.6%	115,085	10.0%	254,685	20.5%
Italy	13,825	3.0%	26,462	2.3%	6,955	0.6%
Luxembourg	15,912	3.4%	126,989	11.0%	227,712	18.3%
Netherlands	70,770	15.2%	295,889	25.7%	363,326	29.2%
Norway	4,198	0.9%	4,997	0.4%	11,535	0.9%
Poland	2,681	0.6%	4,699	0.4%	736	0.1%
Portugal	1,993	0.4%	2,212	0.2%	394	0.0%
Russia	1,555	0.3%	11,289	1.0%	-3,087	-0.2%
Spain	11,745	2.5%	28,371	2.5%	12,847	1.0%
Sweden	10,783	2.3%	16,974	1.5%	-12,119	-1.0%
Switzerland	32,485	7.0%	97,869	8.5%	75,994	6.1%
Turkey	1,741	0.4%	5,994	0.5%	3,933	0.3%
United Kingdom	175,219	37.7%	237,906	20.7%	225,173	18.1%
Other Europe	17,465	3.8%	19,487	1.7%	8,921	0.7%

Source: Bureau of Economic Analysis

and one of Europe's smallest economies has emerged as one of the most attractive anywhere for U.S. firms. Even when adjusting U.S. FDI figures to take account of flows of U.S. holding companies, Ireland still ranks as one of the most attractive places in the world for U.S. businesses.

At the other end of the spectrum are Russia and numerous other European countries, where U.S. FDI inflows have declined over the past few years. U.S. investment in Russia plunged again in 2016, as U.S. companies pulled \$1 billion in investment funds out of the country in the first three quarters of the year. This follows years of decline given the imposition of sanctions on Russia following the Kremlin's annexation of the eastern Ukrainian territory of Crimea

and its military incursions into other areas of Ukraine supporting proxy fighters.

Flows to Austria, Portugal, and Sweden were all lower in the first nine months of 2016 than in the corresponding months of 2015. Disinvestment flows were also reported in the Czech Republic, Portugal and Sweden. Inflows to both Italy and Spain rebounded in 2016, although the figures remain relatively small—just \$754 million to Italy and \$2.4 billion to Spain in the first nine months. In general, weak levels of growth across southern Europe have forced U.S. firms to consolidate and rationalize their European operations, resulting in low levels of investment or outright declines (disinvestment) in many countries.

TABLE 2: TOP 20 U.S. AFFILIATE SALES ABROAD BY DESTINATION* (MILLIONS OF \$)

1982			1990		2000		2014	
Rank	Country	Value	Country	Value	Country	Value	Country	Value
1	United Kingdom	33,500	United Kingdom	51,350	United Kingdom	94,712	Singapore	293,840
2	Switzerland	27,712	Canada	46,933	Canada	94,296	Ireland	284,577
3	Canada	25,169	Germany	41,853	Germany	69,522	Switzerland	224,510
4	Germany	19,117	Switzerland	38,937	Netherlands	67,852	United Kingdom	194,845
5	Netherlands	15,224	Netherlands	33,285	Singapore	56,961	Netherlands	156,295
6	Belgium	11,924	France	24,782	Switzerland	56,562	Canada	153,749
7	Singapore	11,579	Belgium	21,359	Ireland	51,139	Germany	136,267
8	France	11,255	Singapore	15,074	Mexico	37,407	Belgium	86,009
9	Indonesia	8,289	Hong Kong	9,951	France	35,797	Mexico	76,514
10	Hong Kong	4,474	Italy	9,562	Belgium	32,010	France	65,483
11	Italy	3,993	Ireland	9,469	Hong Kong	22,470	Hong Kong	64,044
12	Australia	3,710	Spain	7,179	Malaysia	16,013	China	62,374
13	Ireland	2,842	Japan	7,066	Sweden	15,736	Australia	36,389
14	United Arab Emirates	2,610	Australia	6,336	Italy	14,370	Brazil	31,079
15	Brazil	2,325	Mexico	5,869	Spain	12,928	Spain	30,933
16	Japan	2,248	Indonesia	5,431	Japan	11,845	Japan	29,213
17	Malaysia	2,046	Brazil	3,803	Australia	9,370	Luxembourg	28,461
18	Panama	1,662	Norway	3,565	Brazil	8,987	Norway	28,182
19	Spain	1,635	Malaysia	3,559	China	7,831	Italy	27,741
20	Mexico	1,158	Nigeria	2,641	Norway	6,238	Malaysia	26,467
All Country Total		252,274	All Country Total	398,873	All Country Total	857,907	All Country Total	2,473,870

Source: Bureau of Economic Analysis

*Destination = 3rd Market + Sales to U.S. for majority-owned foreign affiliates.

U.S. foreign direct investment in France and Germany in 2016 was depressed from the robust levels of the prior year. U.S. investment flows in France in the first nine months of 2016 totaled just \$1.3 billion, a 78% decline from the prior year. For all of 2016, we estimate U.S. FDI outflows to France totaled \$1.7 billion, one of the weakest levels of the post-crisis era. It's a similar story for Germany. U.S. FDI flows to Germany totaled \$1.8 billion in the first nine months of 2016, down 60% from the prior year. For the year, inflows amounted to roughly \$2.5 billion.

Combined, U.S. FDI flows to Germany and France, two of Europe's largest economies, totaled just \$4.2 billion in 2016 by our estimates. That is well off the very depressed levels of the past few years, with combined U.S. investment in Germany and France totaling just \$460 million in 2014 and disinvestment of \$963 million in 2013. In contrast, combined U.S. FDI flows to China (including Hong Kong) and India totaled roughly \$11 billion in 2016, a clear signal that more and more U.S. firms are finding better and more favorable market conditions in Asia's largest economies than in

Europe's largest economies. U.S. investment over the past few years in India, which is now growing at a faster pace than China, has been averaging roughly \$3 billion per year, well ahead of U.S. investment in most European countries.

Table 1 highlights the long view of U.S. foreign direct investment in Europe. A few items stand out. First, five countries (Finland, Greece, Hungary, Russia and Sweden) have all experienced net outflows of U.S. investment since the start of this decade. After sinking over \$11 billion into Russia in the first decade of this century, U.S. investment in Russia has dried up since 2010. Second, as mentioned earlier, the share of U.S. FDI in both Germany and France has declined sharply thus far in this decade, with France accounting for just 1.2% of U.S. FDI flows to Europe since 2010. Germany's share is slightly higher, 1.6%, but still off the levels of previous decades. That said, some of these figures need to be used carefully, since some U.S. investment in countries neighboring Germany, for instance the Netherlands, Luxembourg or Belgium, finds its way ultimately to Germany.

Just as U.S. firms leverage different states across America, with certain activities sprinkled around the northeast, midwest, the south and west, so U.S. firms deploy the same strategies across Europe, leveraging the specific attributes of each country. Economic activity across the EU is just as distinct and differentiated by country. Different growth rates, differing levels of consumption, varying degrees of wealth, labor force participation rates, financial market development, innovation capabilities, corporate tax rates—all of these factors, and more, determine where and when U.S. firms invest in Europe.

Table 2 underscores this point. The figures show U.S. affiliate sales to other destinations, or the exports of affiliates per nation. Singapore, strategically located at the center of Southeast Asia and ideally positioned between China and India, ranks as the number one export platform in the world for U.S. multinationals and their affiliates. But note that of the top ten export platforms in the world, seven are in Europe, led by Ireland, Switzerland, the UK, the Netherlands, Germany, Belgium and France. The attraction of many of these countries is due in part to each country's role as a strategic beachhead for U.S. multinationals hoping to penetrate the European Union in a competitive and cost-effective manner.

For decades, the UK was the traditional export platform for U.S. affiliates to the European mainland. The UK still plays an important role in this regard, as we outline in Chapter 1. U.S. affiliates based in the UK export more to the rest of Europe than U.S. affiliates based in China export to the rest of the world.

Nevertheless, the introduction of the euro, the Single Market and EU enlargement have enticed more U.S. firms to invest directly in the continent itself. The extension of EU production networks and commercial infrastructure throughout a larger pan-continental Single Market has shifted the center of gravity in Europe eastward within the EU, with Brussels playing an important role in economic policies and decision-making.

Switzerland, meanwhile, remains a key export platform and pan-regional distribution hub for U.S. firms, evident by the fact that in 2014, the last year of available data, Switzerland ranked as the third largest export platform in the world for U.S. affiliates; the UK ranked 4th, the Netherlands 5th, Germany 7th, Belgium 8th and France 10th.

That said, of all the nations on the table, Ireland stands out as Corporate America's strategic beachhead to the rest of the European Union. Ireland ranked well down the list as

a corporate beachhead for U.S. firms in 1982, ranking 13th in the world in terms of U.S. foreign affiliate exports. Then, U.S. affiliates exports totaled just \$2.8 billion. By 1990 that figure had grown to \$9.5 billion and by 2000, was in excess of \$50 billion. In the first decade of this century, as the industrial and technological capacities of U.S. affiliates in Ireland surged, so did U.S. affiliate exports, soaring nearly six times between 2000 and 2014. Affiliate exports totaled \$285 billion in 2014, trailing only Singapore, but ahead of many others, including Switzerland and the United Kingdom. U.S. firms have leveraged Ireland as an export base to a far greater degree than low-cost locales like Mexico, Hong Kong and China. The latter ranked 12th in 2014. U.S. affiliates export 4.6 times more from Ireland than from China and about 3.7 times more than from Mexico, despite strong NAFTA linkages between the United States and Mexico. On a standalone basis, U.S. affiliates' exports from Ireland are greater than most countries' exports. Such is the export-intensity of U.S. affiliates in Ireland and the strategic importance of Ireland to the corporate success of U.S. firms operating in Europe and around the world.

Of the top twenty global export platforms for U.S. multinationals in the world, eleven are located in Europe, a trend that reflects the intense cross-border trade and investment linkages of the European Union and the strategic way U.S. firms leverage their European supply chains.

Why Europe Still Matters

The secular and structural case for investing in Europe remains relatively positive for a number of reasons. First, while both the United States and China loom large in the hierarchy of the global economy, so does the European Union, still one the largest economies in the world. This fact is often overlooked or ignored by fashionable — and often superficial — political and media consensus, which is more attuned with what's wrong with Europe, as opposed to what's right. In nominal U.S. dollar terms, the European Union (plus Norway, Switzerland, Iceland) accounted for 23.4% of world output in 2016 according to estimates from the International Monetary Fund. Even when the United Kingdom is excluded from the figures, the EU's aggregate output—\$14.9 trillion, or 19.8%—is among the largest in the world. The figure (EU excluding the UK) is slightly less than America's share (24.7%), but in excess of China's—15.1%. Based on purchasing power parity figures, the European Union's share was greater than that of the United States, but slightly less than China's in 2016.

What started out as a loosely configured market of six nations (Belgium, France, West Germany, Italy, Luxembourg and the Netherlands) in the late 1950s is now

**TABLE 3: CUMULATIVE U.S. FDI OUTFLOWS
(MILLIONS OF \$)**

	All Countries	Europe	Europe as a % of World
1950-1959	20,363	3,997	19.6%
1960-1969	40,634	16,220	39.9%
1970-1979	122,721	57,937	47.2%
1980-1989	171,880	94,743	55.1%
1990-1999	869,489	465,336	53.5%
2000-2009	2,056,009	1,149,810	55.9%
2010Q1-2016Q3	2,128,344	1,244,404	58.5%

Source: Bureau of Economic Analysis

an economic behemoth of 28 member states joined together in a Single Market. In other words, the sum of Europe's parts is one of the largest economic entities in the world; as such, Europe remains a key pillar of the global economy and critical component to the corporate success of U.S. firms.

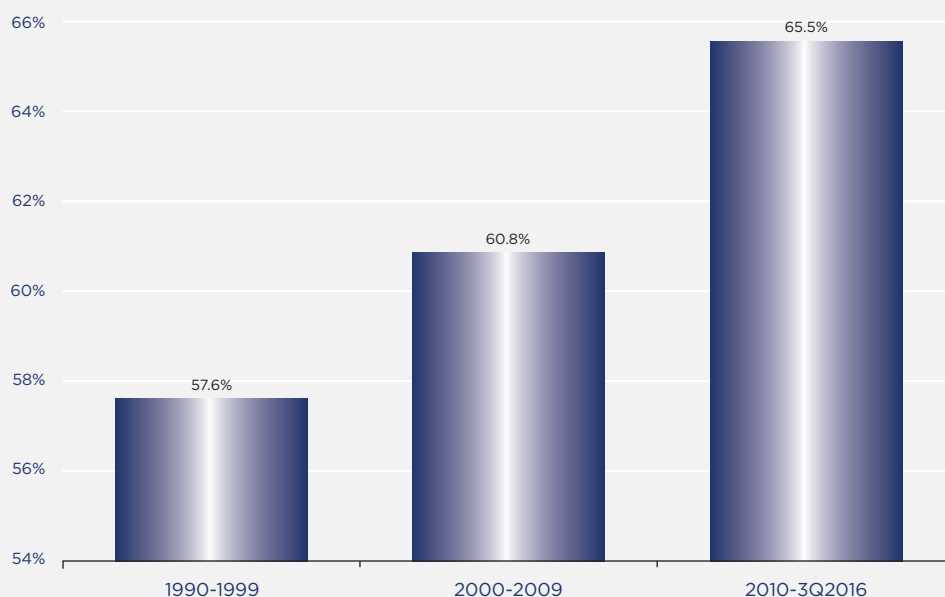
As Table 3 highlights, Europe continues to attract more than half of U.S. aggregate FDI outflows. The region's share of U.S. FDI has remained relatively constant at 58.5% of the

total over this decade, which is up from the first decade of this century as well as from the level of the 1990s. When U.S. FDI flows to Caribbean offshore financial centers are subtracted from the total, Europe's share of U.S. investment climbs even higher, to over 65% (see table 4).

Even after adjusting for FDI flows related to holding companies, Europe remains the favored destination of U.S. firms. That Europe remains the favored destination of U.S. firms runs counter to the fashionable narrative that Corporate America prefers low-cost nations like Asia, Latin America and Africa to developed markets like Europe. Reality is different for a host of reasons.

First, investing in emerging markets such as China, India and Brazil remains very difficult, with indigenous barriers to growth (poor infrastructure, dearth of human capital, corruption, etc.) as well as policy headwinds (foreign exchange controls, tax preferences favoring local firms,) reducing the overall attractiveness of these markets to multinationals.

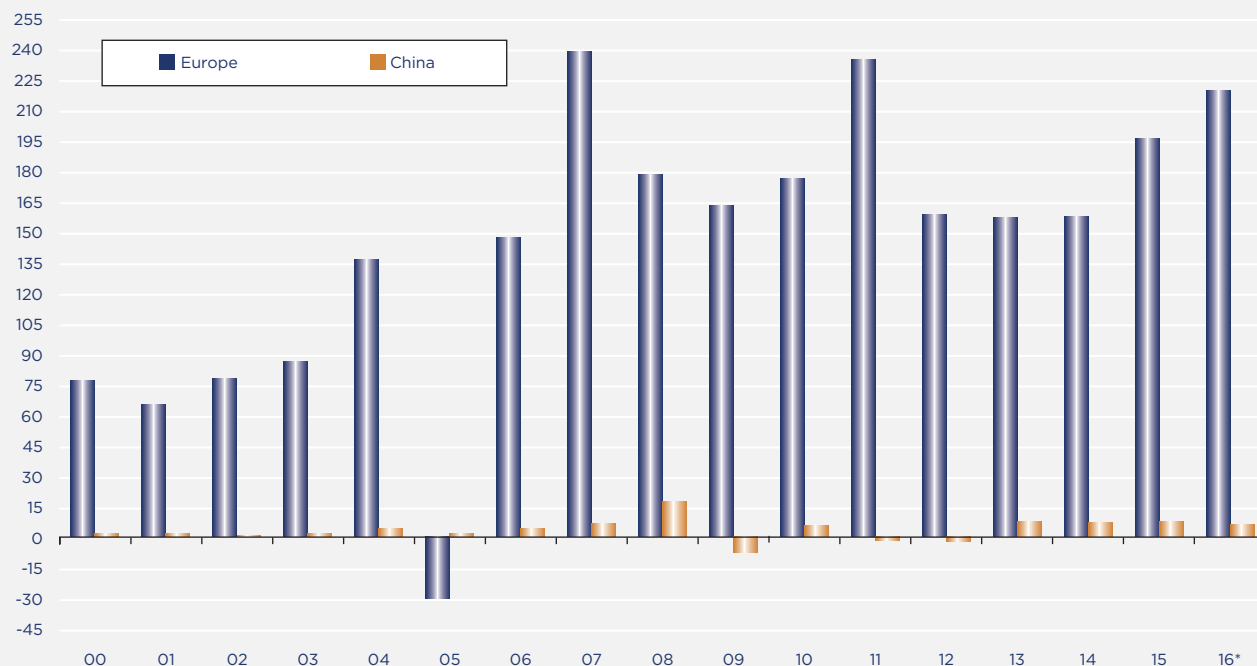
Second, real growth in the emerging markets has downshifted, notably in Brazil, Russia and China. Both

TABLE 4: U.S. FDI FLOWS TO EUROPE - (% OF WORLD TOTAL*)

*Excluding Caribbean and Other Western Hemisphere

Source: Bureau of Economic Analysis

Data as of December 2016.

TABLE 5: U.S. FOREIGN DIRECT INVESTMENT FLOWS TO CHINA VS. EUROPE - BILLIONS OF \$

**2016 estimate based on 1Q-3Q data.*

Source: Bureau of Economic Analysis

Data as of December 2016.

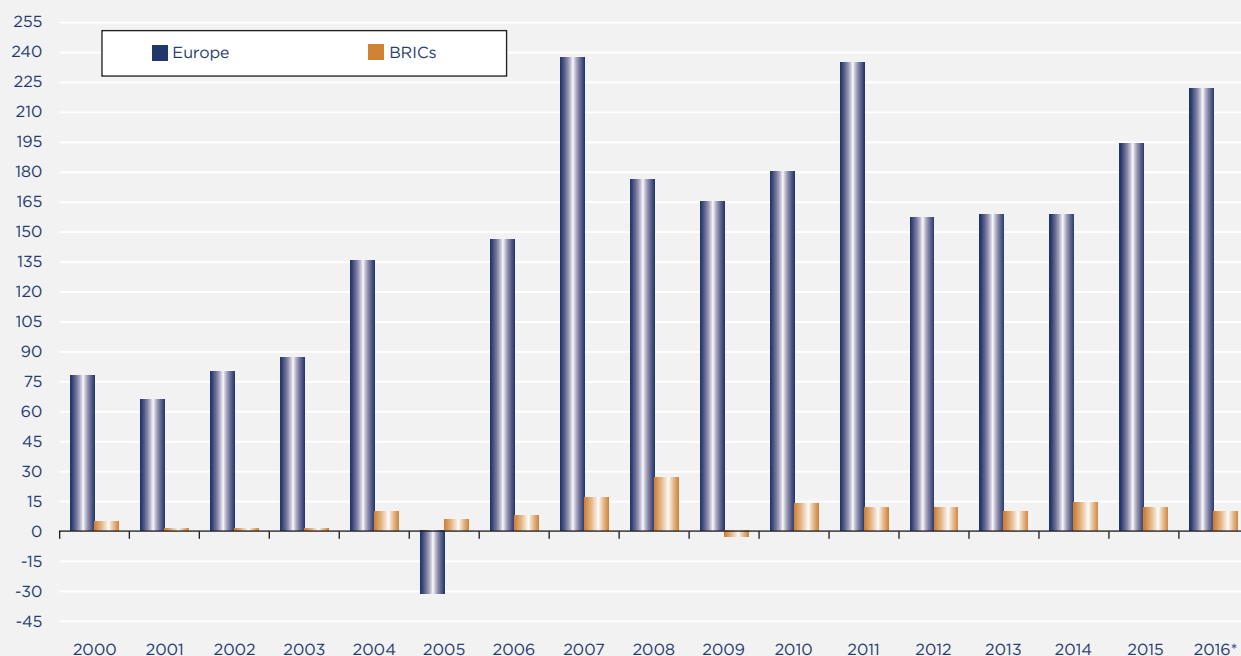
Russia and Brazil are expected to emerge from recession this year, but growth will remain anemic. Growth prospects in China, meanwhile, have slowed considerably as the nation shifts towards more consumption and service-led growth and away from export- and investment-driven growth. 2016 was yet again a very challenging year for China, and more challenges lie ahead. India's economy is on the rebound but the nation is too poor and too closed to make much of difference to the bottom line of Corporate America. In the end, for both cyclical and structural factors, the BRICs and the emerging markets remain a tough sale, difficult places to do business. Hence the wide divergence between U.S. FDI to the BRICs and U.S. FDI to Europe (see Tables 5 and 6).

Third, economic growth in Europe is on the rebound. Real economic activity is accelerating thanks to the ECB's more accommodating monetary policies; lower oil prices; and the weaker euro. All three variables should help produce growth of 1.5-2% in the European Union in 2017, one of the strongest levels in years. Unemployment in many nations has peaked and is trending lower. Stable oil prices have helped fuel personal consumption, while the weaker euro has boosted export prospects across the region.

Of course, in past years many U.S. companies have been attracted to the super-charged economies of China, Brazil, and India. But these economies are not so "supercharged" anymore. Growth in all three countries, notably Brazil and China, has slowed dramatically over the past several years; the high flyers are now low flyers.

Fourth, in addition to being on the mend and one of the largest economic blocs in the world, Europe is also wealthy, and wealth matters. Wealth is correlated with highly skilled labor, rising per capita incomes, innovation, and a world class R&D infrastructure, among other things. In the aggregate, 15 of the 25 wealthiest nations in the world are European. Per capita income levels in Europe are light years ahead of those in India and China, and all of Africa.

While much has been made of the rise of China, with the mainland's economy now the second largest in the world, the Middle Kingdom remains relatively poor, with China's per capita income totaling just \$8,028 in 2015, according to figures from the World Bank. The Chinese figure ranks 74th in the world and is well below the per capita income levels of Sweden (\$50,580), the Netherlands (\$44,300), Finland (\$42,311), Germany (\$41,313), and the European

TABLE 6: U.S. FOREIGN DIRECT INVESTMENT OUTFLOWS TO THE BRICs VS. EUROPE¹ - (BILLIONS OF \$)

¹ Europe does not include flows to Russia.

*2016 Estimate based on 1Q-3Q data.

Source: Bureau of Economic Analysis.

Data as of December 2016.

Union average of around \$32,000. With a miserly per capita income of about \$1,500, India ranks 140th.

Wealth drives consumption, with the EU accounting for nearly 22% of global personal consumption expenditures in 2015, a slightly lower share than that of the United States but well above that of China (roughly 10%) and India (less than 3%) and the BRICs combined (roughly 17%). Gaining access to wealthy consumers is among the primary reasons why U.S. firms invest overseas, and hence the continued attractiveness of wealthy Europe to American companies.

Europe is also attractive because of the ease of doing business in the region. Just as the macroeconomic backdrop influences any business climate, so do micro factors. Country and industry regulations can help or hamper the foreign activities of U.S. multinationals, and greatly influence where U.S. companies invest overseas. Think property rights, the ability to obtain credit, regulations governing employment, the time it takes to start a business, contract enforcements, and rules and regulations concerning cross border trade. These and other metrics influence and dictate the ease of doing business, and on this basis many Europe countries rank as the most attractive in the world.

The World Bank annually ranks the regulatory environment for domestic firms in 190 nations, a ranking which serves as very good proxy for the ease of doing business for domestic and foreign companies alike. And in the 2017 Ease of Doing Business rankings, 16 European economies ranked among the top 25 most business-friendly countries. Denmark ranked 3rd overall, followed by Norway (6th), the United Kingdom (7th), Sweden (9th), Macedonia (10th), Estonia (12th), Finland (13th), Latvia (14th), Georgia (16th), Germany (17th), Ireland (18th), Austria (19th), Iceland (20th), Lithuania (21st), Poland (24th), and Portugal (25th). See Table 7.

Outliers include Russia, ranked 40th, Croatia, ranked 43th, Italy, ranked 50th, and Greece, ranked 61st. Reflecting the challenging business environment of many key emerging markets, China ranked 78th in terms of ease of doing business in the latest rankings, while Brazil ranked 123rd and India clocked in at 130th. These countries are regularly hyped as among the most dynamic in the world, yet strong real GDP growth does not necessarily equate to a favorable environment for business. Other factors need to be factored into the equation, like the rise of state capitalism in many developing nations,

TABLE 7: EASE OF DOING BUSINESS 2017

Rank	Country	Rank	Country
1	New Zealand	16	Georgia
2	Singapore	17	Germany
3	Denmark	18	Ireland
4	Hong Kong	19	Austria
5	Korea	20	Iceland
6	Norway	21	Lithuania
7	United Kingdom	22	Canada
8	United States	23	Malaysia
9	Sweden	24	Poland
10	Macedonia	25	Portugal
11	Taiwan	26	United Arab Emirates
12	Estonia	27	Czech Republic
13	Finland	28	Netherlands
14	Latvia	29	France
15	Australia	30	Slovenia

Source: World Bank, Ease of Doing Business Report 2017.

continued intellectual property right infringements, capital controls, and discriminating domestic policies against foreign firms. These factors have become favorite policy tools in many key emerging markets, further enhancing the attractiveness of Europe in the eyes of U.S. multinationals.

In the end the greater the ease of doing business in a country, the greater the attractiveness of that nation to U.S. firms. The micro climate matters just as much as the macro performance; Europe trumps many developing nations by this standard.

In addition, despite numerous structural challenges in Europe and notwithstanding current market problems, many European economies remain among the most competitive in the world. For instance, in the latest rankings of global competitiveness from the World Economic Forum, six European countries were ranked among the top ten, and seven more among the top twenty-five. Switzerland ranked first, the Netherlands 4th, Germany 5th, Sweden 6th, the United Kingdom 7th and Finland 10th. Meanwhile, Norway ranked 11th, Denmark ranked 12th, Belgium 17th, Austria 19th, Luxembourg 20th, France 21st, and Ireland 23rd (see table 8).

The United States, by way of comparison, ranked 3rd in the latest rankings.

TABLE 8: TRANSATLANTIC ECONOMIES ARE THE MOST COMPETITIVE IN THE WORLD

Global Competitiveness Index 2016-2017

Rank	Country	Rank	Country
1	Switzerland	16	United Arab Emirates
2	Singapore	17	Belgium
3	United States	18	Qatar
4	Netherlands	19	Austria
5	Germany	20	Luxembourg
6	Sweden	21	France
7	United Kingdom	22	Australia
8	Japan	23	Ireland
9	Hong Kong	24	Israel
10	Finland	25	Malaysia
11	Norway	26	Korea
12	Denmark	27	Iceland
13	New Zealand	28	China
14	Taiwan	29	Saudi Arabia
15	Canada	30	Estonia

Source: World Economic Forum,
Global Competitiveness Report 2016-2017

At the other end of the spectrum, a handful of European nations scored poorly, underscoring the fact that Europe's competitiveness is hardly homogenous. A handful of nations did not even score in the top fifty—Slovenia ranked 56th, Romania 62nd, Hungary 69th, Croatia 74th, while Greece ranked 86th in the latest survey, the worst performer among EU members.

The spread between Number One Switzerland and floundering Greece underscores the divergent competitiveness of the EU and highlights the fact that various nations exhibit various competitive strengths and weaknesses. For instance, Greece received low marks for its public institutions and inefficient labor markets, which stands in contrast to Ireland's well-functioning labor force or Norway's highly ranked public institutions.

Belgium was cited for outstanding health indicators and primary education; France was highlighted for its transport links and energy infrastructure, as well as strengths in quality of education, sophistication of business culture, highly developed financial markets, and leadership in innovation. Estonia, Poland and the Czech Republic were cited for their top notch education systems and flexible labor markets; Spain's ranking was hurt by macroeconomic imbalances but scored relatively well in terms of ICT usage. Italy's labor force remains quite rigid but the nation scored well in terms of producing goods high up in the value chain. Finally, Germany ranked highly across many variables:

quality of infrastructure, efficient goods market, R&D spending and domestic market size, among other things.

All of the above is another way of saying that there is a great deal more to Europe than the daily diet of negative headlines. The various countries of Europe offer specific micro capabilities/competencies that are lacking on a relative basis in the United States and critical to the global success of U.S. firms.

Finally, Europe is no slouch when it comes to innovation and knowledge-based activities. Based on the Innovation Union Scoreboard for 2016, Denmark, Finland, Germany, the Netherlands and Sweden rank as innovation leaders in Europe. These are the most innovative states in the EU, performing well above that of the EU 28 average. Hence this group was dubbed “innovation leaders”.

So-called “strong innovators” include Austria, Belgium, France, Ireland, Luxembourg, Slovenia and the UK. The performance of Croatia, Cyprus, Czech Republic, Estonia, Greece, Hungary, Italy, Latvia, Lithuania, Malta, Poland, Portugal, Slovakia, and Spain was below that of the EU average; these nations are considered moderate innovators. The laggards, or modest innovators, include Bulgaria and Romania.

While significant discrepancies exist among nations in the EU as to knowledge-based capabilities, the innovation performance of the EU remains ahead of Australia, Canada and all BRIC nations. In addition, based on the latest figures, the EU is closing its performance gap with Japan and the United States.

In that R&D expenditures are a key driver of value-added growth, it is interesting to note that Europe-based companies accounted for roughly 21-22% of total global R&D in 2014 and 2015. That lagged the share of the United States (26.9% in 2014) but exceeded the global share of R&D spending in Japan (9.1%), China (19.1%), and India (3.4%). In 2014, Germany, Sweden, Switzerland, Finland, and Denmark spent more than the United States on R&D as a percentage of GDP.

Led by European industry leaders like Roche, Novartis, Daimler, Sanofi, and GlaxoSmithKline, Europe remains a leader in a number of cutting-edge industries including life sciences, agriculture and food production, automotives, aerospace, nanotechnology, energy, and information and communications. Innovation requires talent and on this basis, Europe is holding its own relative to other

parts of the world. To this point, Europe is among one of the world leaders in producing science and engineering graduates, with the EU. According to the latest data from the U.S. National Science Board’s Science and Engineering Indicators, the EU accounted for 12% of global science and engineering graduates. America’s share was just 9% of the global total. Of the world’s global research pool, the EU housed 1.7 million researchers in 2013 versus 1.3 million in the United States. The EU accounted for about 26% of the global total.

The EU remains notably strong in such high-technology manufacturing industries as pharmaceuticals and scientific instruments and aerospace. Against this backdrop, the EU is the largest exporter of commercial knowledge-intensive services (excluding intra-EU exports).

Finally, in terms of future workers, the U.S. high school graduation rate lags behind most European nations, including states like Austria, Denmark, Finland, Germany, Greece, Hungary, Italy, Iceland, Ireland, Latvia, the Netherlands, Norway, Poland, Portugal, Slovakia, and Slovenia. The U.S. graduation rate was 82% in 2013-14 versus an OECD average of 85%.

While U.S. universities remain a top destination for foreign students, the UK, Germany and France are also notable attractions. In the end, Europe remains among the most competitive regions in the world in terms of science and technology capabilities. The U.S. National Science Board has explicitly recognized EU research performance as strong and marked by pronounced EU-supported, intra-EU collaboration.

Adding It All Up

Europe, long the weak link of the global economy, is in recovery mode and remains a formidable economic entity. While the global brand of Europe has been battered over the past few years, the region remains quite large, wealthy, richly endowed, open for business, and technologically out in front in many key global industries.

Due to all of the above, Europe will remain a critical and indispensable geographic node in the global operations of U.S. companies. Remember: U.S. multinationals increasingly view the world through a tri-polar lens—a world encompassing the Americas, Europe and Asia, along with attendant offshoots. In this tri-polar world, U.S. companies are not about to give up on or decamp from one of the largest segments of the global economy.

U.S. FDI Outflows to Europe Adjusted for Flows of Holding Companies

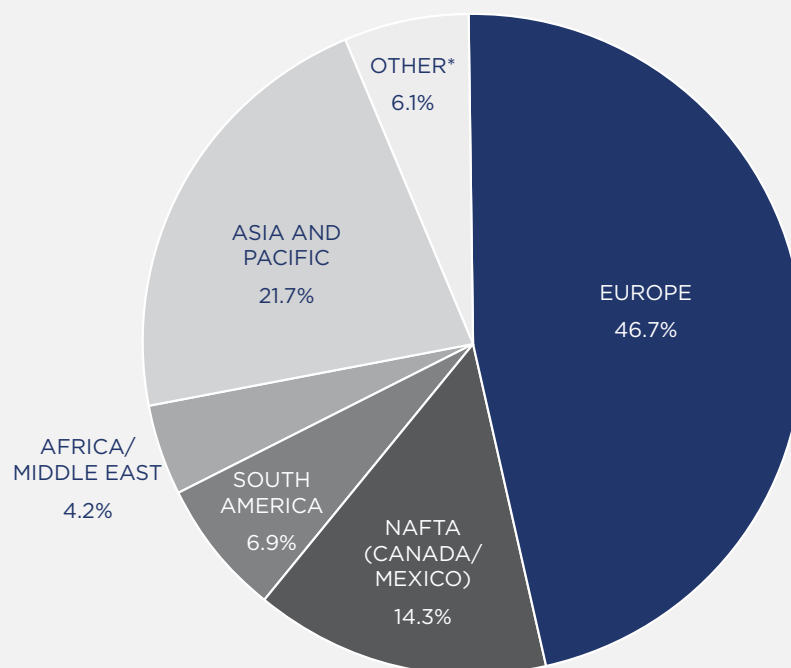
Holding companies account for a growing share of total U.S. FDI outflows to Europe. This has generated considerable political and media attention, and is important to understand in order to get a full picture of transatlantic commercial linkages.

In 2015, the last year of available data, holding companies accounted for \$167 billion, or over half of global U.S. FDI of \$303 billion, and 60% of total U.S. foreign direct investment to the European Union of \$179.5 billion. As the U.S. Bureau of Economic Analysis notes, “The growth in holding-company affiliates reflects a variety of factors. Some holding-company affiliates are established primarily to coordinate management and administration activities—such as marketing, distribution, or financing—worldwide or in particular geographic region. In addition, the presence of holding-company affiliates in countries where the effective income tax rate faced by affiliates is relatively low suggests tax considerations may have also played a role in their growth. One consequence of the increasing use of holding companies has been a reduction in the degree to which the U.S. Direct Investment Abroad position (and related flow) estimates reflect the industries and countries in which the production of goods and services by foreign affiliates actually occurs.”

Against this backdrop, total U.S. FDI flows to Europe over the past few years have been driven in part by holding companies. In 2009, for instance, holding companies accounted for 51% of total U.S. FDI flows to the Europe. In 2010 and 2011, the shares were 73% and 62%, respectively. Holding companies accounted for 57% of total U.S. outflows to Europe in 2012, 67% in 2013, 62% in 2014, and 59% in 2015. The countries attracting the most investment of holding companies, not surprisingly, are those with some of the lowest corporate tax rates in Europe — Luxembourg, the Netherlands, the UK and Ireland.

The bottom line: when FDI related to holding companies is stripped from the numbers, U.S. FDI outflows are not as large as typically reported by the Bureau of Economic Analysis. Nonetheless, Europe remains the top destination of choice among U.S. firms even after the figures are adjusted. As shown in Table 9, between 2009 and 2015, Europe still accounted for over 46% of total U.S. FDI outflows when flows from holding companies are removed from the aggregate. Europe’s share was still more than double the share to Asia, underscoring the deep and integrated linkages between the United States and Europe.

**TABLE 9: U.S. FDI OUTFLOWS EXCLUDING FLOWS TO NONBANK HOLDING COMPANIES
2009-2015 - (% OF TOTAL)**



**Includes Central America (excluding Mexico) and Other Western Hemisphere.
Source: Bureau of Economic Analysis.
Data as of February 2017.*