The Transatlantic Economy: It's Time for a Renaissance

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The transatlantic economy, purposefully designed for success in the aftermath of World War II, has produced the largest and the most successful trading block in the world. Driven by innovation, rules-based institutions, technological competitiveness and knowledge creation, the transatlantic economy makes up 43% of the global economy, with $36 trillion in real GDP.

The rise of China represents significant challenges for the future prosperity of the transatlantic community. Today, China's real GDP ($15 trillion) is approximately 42% of the transatlantic economy compared to only 7% two decades ago. Over this period, the Chinese economy has grown by a factor of 12, and the transatlantic economy by only two times. China has benefitted from the western-based international order and the unlimited free market access, while continuously flaunting these rules under its state driven economic model. Unfair business practices, heavy state subsides, dumping procedures, illegal technology transfer and cyber espionage, bribery and coercion, and lack of reciprocity for market access have strategic implications on American and European companies.

Trade levels between the United States and the European Union (E.U.) dwarf by far trade activities with China. Transatlantic trade levels (in goods and services) totaled more than $1.3 trillion, as big as the sum of U.S.-China trade ($636 billion) and E.U.-China ($718 billion). Since 2000, trade activities across the Atlantic doubled. On the other hand, China's trade with the United States has increased fivefold, and with the E.U. eightfold. Huge trade deficits characterize the European ($146 billion) and American ($307 billion) trade with China. As a result of the industrial off-shoring and transfer of the global value chains, China has become not only the largest exporter of goods in the global economy, accounting for 18% of the share of world exports, but it has also created some dangerous strategic dependencies on Chinese goods for western countries.

The most important element of the transatlantic economy is mutual investment, often overlooked and sidelined by trade disputes. Since 2000, transatlantic trade activities have increased twice, while mutual FDI more than 5 times. Foreign affiliate sales, not trade, are the primary means by which American and E.U. firms deliver goods and services to transatlantic consumers. With a total of $6.2 trillion, the United States and the E.U. are each other's primary source and destination of foreign direct investment (FDI). This activity directly employs more than 16 million workers. To put it into perspective, U.S. investment in Europe makes up roughly 60 percent of the total stock of U.S. outward investment globally. American investment in Europe is 31 times higher than in China. Similarly, European investment makes up 68 percent of the total stock of foreign investment in the United States, compared to less than 1% of the Chinese FDI in the United States.

A Transatlantic Economic Renaissance

Rebooting the transatlantic economy will require a powerful western re-invention. A new visionary strategy that reasserts our common ideals, values, interests, and standards is desperately needed. Both sides of the Atlantic need to pursue economic growth opportunities. Developing human talent, promoting free trade and innovation while tackling high sovereign deficits, and emerging global security challenges. The massive monetary relief support that the United States and European countries are pumping into their economies to recover from the crisis, needs to be carefully designed to support the transatlantic partnership. It should be geared towards reinvigorating the competitiveness of the West and promoting conditions for the United States and the E.U. to lead in a "values" based market. Preserving our common prosperity will require an effective transatlantic strategy focused on the addressing the hardest issues, which are also the most important ones.

Harmonization of investment rules across the Atlantic should be the main objective of a stronger transatlantic partnership. There is much room for improvement on regulatory provisions, the elimination of non-tariff barriers and restrictions, and increased common access to services, procurement opportunities, and digital markets. After the 2008-2009 crisis, mutual investment drove the economic recovery on both sides of the Atlantic. Since 2009, mutual FDI doubled, reaching $6.3 trillion. Harmonization of investment rules would reduce costs and lead to a greater degree of interaction between the 48 million Small and Medium Enterprises across the Atlantic. This would not only be a key driver for economic growth and job creation, but also play an important role in generating innovation. Investment standards negotiated between the United States and the E.U. would become the benchmark for global rules by creating a level playing field for competition and doing away with competing standards.

The liberalization of the service market should also be an important element of a renewed transatlantic partnership. The United States and Europe are the two leading economies in the world and each other's most important and profitable partner in the service sector. The services sector is the fastest growing segment of global trade with the WTO forecasting that services could account for up to one-third of world trade by 2040. A number of changes such as reducing market entry fixed costs, establishing e-commerce protocols, resolving data privacy issues, standardizing service-related activities, converging procurement rules and regulations, mutual recognition of professional qualifications, and cooperating in research and development are badly needed and achievable. Success would create real transatlantic market opportunities in sectors such as 5G networks, fiber optic infrastructures, and global telecommunications networks. Any successful transatlantic agreement on services would be the basis for negotiations for other international trade services agreements.

Transatlantic cooperation in science and R&D is the cornerstone of our common economic progress and prosperity. As differences across the world are narrowing, and with China becoming the second biggest spender in R&D ($462 billion, in 2018) after the United States ($551 billion), the transatlantic economy risks losing its leading position. Beijing's "Made in China 2025" plan centers on building up its technological competencies to reduce dependence on foreign technology. This is at the heart of China's self-reliance industrial strategy while serving to promote its mercantilist expansion abroad.

A Transatlantic Strategy towards China is needed. The key elements need to be focus on the economics, security and technology. A joint approach based on "transatlantic sovereignty," and not separate approaches. Strategic coordination is key to increase transatlantic resilience in protecting markets, businesses, technologies, and critical infrastructure. Only through a coordinated approach will the United States and the E.U. have a stronger bargaining position to force reciprocity with regard to political and investment relations with China. After seven years of tough negotiations, the E.U. agreed on the E.U.-China Comprehensive Agreement on Investment (CAI) with the aim to increase transparency, prevent the forced transfer of technology, and promote reciprocity. However, considering Beijing's resistance in the past to meet requirements and implement standards, only a common transatlantic approach would pressure China to respect regulations of free market economies.

A coordinated U.S.-E.U. FDI Screening Framework is also required. This would be a critical enabler for transatlantic companies and protect them from unfair foreign takeovers. The current economic crisis will have a direct negative impact on global capital flows and will create buying opportunities in Europe and elsewhere as markets and prices plummet. This could benefit China if not carefully managed. A case in point is the post 2008 crisis when Chinese firms acquired discounted assets, especially in Europe. Chinese investment increased by 50 times, from less than $840 million in 2008 to a record high of $42 billion in 2016. However, it is not simply a fire sale. Beijing has a diversified strategy in Europe with a focus on capital investments in specific European countries. Whether large infrastructure development projects on the periphery, or specific high tech companies elsewhere, the stock of Chinese FDI in the EU have reached $195.

In 2019, the E.U. enacted a regulation "establishing a framework for the screening of foreign direct investment but only a handful of countries have enacted national legislation consistent with the regulation. Better cooperation and exchange of best practices is urgently needed to establish common guidelines for information exchange and coordination, and empowerment for national screening. Transatlantic partnership on screening of FDI should be extended beyond the E.U., to include countries in the Western Balkans and Eastern Partnership countries. This would allow for better optics on China's investment and influence strategy through its BRI and "17+1" platforms.

Transatlantic supply chains need to be rebuilt to provide redundancy in key national security sectors and to eliminate dependencies on China. The pandemic surfaced the critical dependence of western countries on Chinese products. Chinese related supply chains related to software for critical infrastructures and emerging technologies must be carefully assessed for their national security ramifications. The transatlantic partnership should establish critical western infrastructure development protocols to avoid over-dependence on China. The need to "re-shore" the production of critical goods within the transatlantic economy and diversify production networks is needed. New investments, in automation, robotics, and artificial intelligence will prove to be cost effective investments in the long term by providing for security and prosperity within the community. Lastly, more attention needs to be devoted to Central, Eastern and Southeastern Europe, to support the socio-economic development of countries who are currently vulnerable to economic coercion from China.

Charts

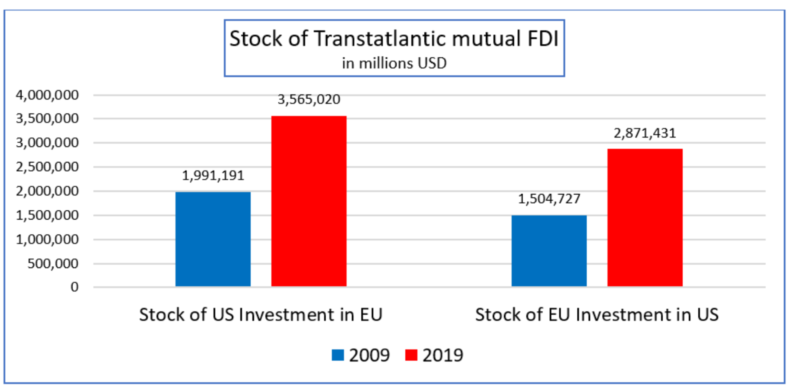

Figure 1: Transatlantic Foreign Direct Investment. Source: Bureau of Economic Analysis, U.S. Department of Commerce

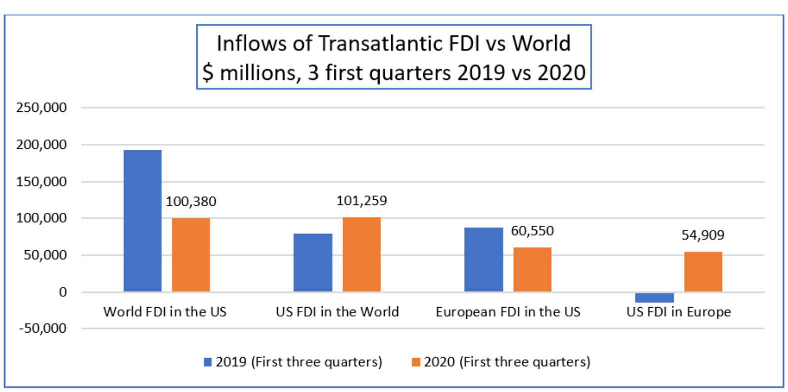

Figure 2: Decrease of FDI Flows in 2020. Source: Bureau of Economic Analysis, U.S. Department of Commerce