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European Countries: U.S.-Related Jobs, Trade and Investment

Real economic growth in the eurozone
(estimate 2018)

Slowed to **1.8%**

U.S. FDI stock in Europe
(2017)

$3.6 trillion

59% of the total U.S. global investment position

Over the past year, Europe has had to navigate a series of shocks, ranging from uncertainty over the United Kingdom's Brexit negotiations with the European Union and disputes over Italy's budget plans to protests in France, trade tensions with the United States, and financial stress in Turkey. Amidst all the uncertainty and fears of a global growth slowdown, the European economy ended 2018 in a less stable position than it had been in when the year began. Real economic growth, as high as 2.4% in 2017, slowed to an estimated 1.8% for the eurozone in 2018. Looking ahead, the IMF projects eurozone growth to weaken slightly to 1.6% in 2019 and 1.7% in 2020.

The slowdown in Europe's economy in 2018 can be attributed to a number of factors: trade and investment uncertainty, the rollout of new EU emissions standards for the auto industry, and a slowdown in China – a major trading partner for the EU. 2019 brings a handful of additional risks that economists, investors and business leaders should monitor closely, including elections for the European Parliament and the subsequent formation of a new European Commission, Presidential elections in Ukraine amidst continuous Russian meddling and aggression, a March 29th Brexit deadline, adoption of a new EU e-privacy regulation that supplements the EU's 2018 General Data Protection Regulation (GDPR), and higher-than-expected government deficits in some EU member countries. Meanwhile, the rise of populist pressures across the continent will remain a key area of focus.

Notwithstanding these risks, Europe remains one of the most attractive regions of the world for U.S. FDI. The latest economic figures underscore corporate America's enduring commitment to its long-standing transatlantic partner. Measured on a historic cost basis, the total stock of U.S. FDI in Europe was $3.6 trillion in 2017, or 59% of the total U.S. global investment position. This is more than three-and-a-half times the amount of comparable U.S. investment in the Asia-Pacific region.

While FDI flows from the United States have historically been directed towards Europe – with Europe usually attracting more than 50% of U.S. investment each year – 2018 was not a typical year for U.S. capital outflows. Due to large scale repatriations of U.S. multinational companies' accumulated foreign earnings, U.S. FDI outflows to Europe were negative for the first nine months of the year, or -$13 billion. These repatriations of cash – brought about by a major tax overhaul in the United States that encouraged companies to bring home foreign capital at lower tax rates – spanned multiple regions, from the Caribbean to Europe to the Asia-Pacific region (See Box 1).

In total, U.S. global FDI outflows were -$125 billion from Q1-Q3 of 2018, compared to a positive $240 billion during the same period a year earlier. Most of the decline was caused by U.S. companies with offshore operations in Bermuda; these firms repatriated large quantities of accumulated capital, leading to a net -$148 billion outflow in the first three quarters of 2018. FDI in Europe was also impacted by the change to the U.S. tax code. The Netherlands had the largest negative outflows in Europe (-$35 billion from Q1-Q3 2018). Meanwhile, U.S. FDI flows to Ireland were -$20 billion in the first nine months of 2018. This is small compared to the $376 billion worth of U.S. FDI outflows directed to Ireland over the past ten years. By comparison, Bermuda's -$148 billion outflow last year (Q1-Q3) came after it received only about $200 billion in U.S. investment in the previous ten years.

At the other end of the spectrum are countries where U.S. FDI flows actually increased in the first nine months of 2018, compared to the previous year. These include France (+18%), Italy (+79%) and Spain (+55%). Investment in Belgium, Germany, Luxembourg, the UK and numerous other European countries was positive in 2018, though lower than the prior year, according to our estimates.

U.S. FDI activity in Europe has become more concentrated over the years. For a variety of reasons, ranging from the cost of labor to country-specific tax rates, firms are doing more activities in less locations across the region. In 2017, of the $164 billion of investment that Europe received from the United States, 87% went to four countries: Ireland ($45 billion), the Netherlands ($35 billion), Luxembourg ($33 billion), and Switzerland ($30 billion). That said, some of these investment flows, ultimately make their way to neighboring countries, so they likely misrepresent the ultimate destination of U.S. direct investment.

Box 1. U.S. Corporate Tax Reform: Impact on FDI Outflows

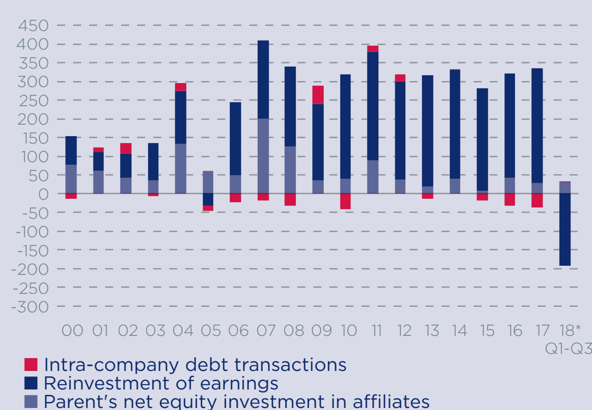
In December 2017, the United States passed the "The Tax Cuts and Jobs Act," which included several changes to the U.S. taxation of international profits. An important provision of the tax reform bill, which had a material impact on U.S. international investment flows, was the reduced tax rate on U.S. firms' repatriated earnings. This repatriation tax break, which was expected, led to negative U.S. FDI outflows as companies brought home significant quantities of cash. The sweeping U.S. tax reform package also reduced the corporate tax rate from 35% to 21% and moved the United States towards a "territorial" system, under which profits earned by U.S. foreign affiliates will not be taxed.

For years, U.S. multinational companies reinvested their global earnings back into their operations abroad to defer U.S. taxation of these foreign profits. This strategy, widely adopted by U.S. multinationals, caused reinvested earnings to become the primary source of U.S. FDI flows. Table 1a shows the breakout of U.S. global FDI flows by component, with retained earnings making up the bulk of total U.S. investment.

The cumulative effect of years of companies keeping profits overseas led to a large accumulation of U.S. corporate earnings abroad. When the U.S. government passed corporate tax reform, reducing the tax rate on these earnings, it allowed companies to tap into the large pile of foreign profits by repatriating the foreign capital. When companies withdraw prior accumulated earnings, this results in negative retained earnings and negative overall U.S. FDI outflows. A similar pattern occurred in 2005 after the U.S. Homeland Investment Act introduced a similar tax break for multinational companies (Table 1b).

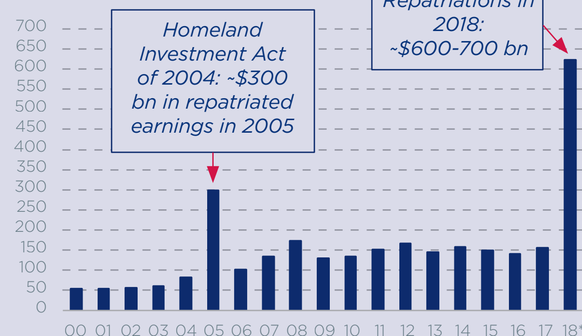
In the first three quarters of 2018, U.S. repatriations of global earnings are estimated to have totaled approximately $600-700 billion. This is relatively small compared to the estimated $2.7 trillion in funds stockpiled overseas. These repatriations and negative FDI outflows are likely a to be a short-term anomaly in the data. According to UNCTAD's January 2019 Investment Trends Monitor, however, in the long run the shift to a territorial tax system in the United States may lead to "structurally lower reinvested earnings by U.S. multinationals in the future."

Table 1a U.S. Global Outflows by Component
(Billions $)



*Seasonally adjusted.
Source: U.S. Bureau of Economic Analysis.
Data as of December 2018.

Table 1b U.S. Repatriations of Global Earnings
(Billions $)



*2018 estimate based on three quarters of data.
Source: U.S. Bureau of Economic Analysis.
Data as of December 2018.

These figures underscore that changes in quarterly, and even annual, FDI flows can be an extremely volatile measure of U.S.-European investment ties. Table 2 provides a more long-term view of U.S. foreign direct investment across Europe. A few items stand out. First, three countries on the list (Finland, Russia and Sweden) have 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 this decade, with France accounting for just 1.4% of U.S. FDI flows to Europe since 2010. Germany's share is slightly higher, 1.7%, 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, Belgium or Luxembourg, ultimately finds its way to Germany.

Table 2 U.S. FDI in Europe: The Long View (Millions of $, (-) inflows)

Country	1990-1999		2000-2009		2010-3Q2018	
	$ Aggregate Total	% of Total	$ Aggregate Total	% of Total	$ Aggregate Total	% of Total
Europe	465,337		1,149,810		1,377,570	
Austria	2,908	0.6%	501	0.0%	7,939	0.6%
Belgium	12,028	2.6%	40,120	3.5%	17,869	1.3%
Czech Republic	155	0.0%	1,941	0.2%	3,532	0.3%
Denmark	2,798	0.6%	5,782	0.5%	9,948	0.7%
Finland	1,485	0.3%	1,598	0.1%	-447	0.0%
France	29,063	6.2%	42,963	3.7%	19,159	1.4%
Germany	31,817	6.8%	60,363	5.2%	23,558	1.7%
Greece	413	0.1%	943	0.1%	388	0.0%
Hungary	2,929	0.6%	1,376	0.1%	835	0.1%
Ireland	21,369	4.6%	115,085	10.0%	300,147	21.8%
Italy	13,825	3.0%	26,462	2.3%	8,622	0.6%
Luxembourg	15,912	3.4%	126,989	11.0%	271,604	19.7%
Netherlands	70,770	15.2%	295,889	25.7%	346,369	25.1%
Norway	4,198	0.9%	4,997	0.4%	9,441	0.7%
Poland	2,681	0.6%	4,699	0.4%	1,776	0.1%
Portugal	1,993	0.4%	2,212	0.2%	1,226	0.1%
Russia	1,555	0.3%	11,289	1.0%	-1,437	-0.1%
Spain	11,745	2.5%	28,371	2.5%	13,241	1.0%
Sweden	10,783	2.3%	16,974	1.5%	-5,200	-0.4%
Switzerland	32,485	7.0%	97,869	8.5%	104,347	7.6%
Turkey	1,741	0.4%	5,994	0.5%	5,120	0.4%
United Kingdom	175,219	37.7%	237,906	20.7%	245,577	17.8%
Other	17,465	2.6%	19,487	1.4%	-6,044	-0.4%

Source: Bureau of Economic Analysis.

Ireland has become a favored destination for FDI among U.S. multinationals looking to take advantage of the country's flexible and skilled English-speaking labor force, low corporate tax rates, membership in the European Union, and pro-business policies. Add in Ireland's economic rebound – the Irish economy is among the fastest-growing in the world – and one of Europe's smallest economies has emerged as one of the most attractive destinations 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.

Just as U.S. firms leverage different states across America, with certain activities sprinkled around the Northeast, Midwest, the South and West, 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 3 **Top 20 U.S. Affiliate Sales Abroad by Destination*** ($Millions)

	1982		1990		2000		2016	
Rank	Country	Value	Country	Value	Country	Value	Country	Value
1	United Kingdom	33,500	United Kingdom	51,350	United Kingdom	94,712	**Ireland**	**292,885**
2	Switzerland	27,712	Canada	46,933	Canada	94,296	Singapore	264,012
3	Canada	25,169	Germany	41,853	Germany	69,522	Switzerland	239,549
4	Germany	19,117	Switzerland	38,937	Netherlands	67,852	United Kingdom	172,905
5	Netherlands	15,224	Netherlands	33,285	Singapore	56,961	Netherlands	154,114
6	Belgium	11,924	France	24,782	Switzerland	56,562	Germany	138,217
7	Singapore	11,579	Belgium	21,359	**Ireland**	**51,139**	Canada	125,241
8	France	11,255	Singapore	15,074	Mexico	37,407	Mexico	79,817
9	Indonesia	8,289	Hong Kong	9,951	France	35,797	Hong Kong	74,431
10	Hong Kong	4,474	Italy	9,562	Belgium	32,010	Belgium	62,951
11	Italy	3,993	**Ireland**	**9,469**	Hong Kong	22,470	China	57,245
12	Australia	3,710	Spain	7,179	Malaysia	16,013	France	53,805
13	**Ireland**	**2,842**	Japan	7,066	Sweden	15,736	Spain	29,805
14	United Arab Emirates	2,610	Australia	6,336	Italy	14,370	Luxembourg	29,534
15	Brazil	2,325	Mexico	5,869	Spain	12,928	Japan	28,418
16	Japan	2,248	Indonesia	5,431	Japan	11,845	Brazil	28,201
17	Malaysia	2,046	Brazil	3,803	Australia	9,370	Australia	27,801
18	Panama	1,662	Norway	3,565	Brazil	8,987	India	26,740
19	Spain	1,635	Malaysia	3,559	China	7,831	Italy	25,772
20	Mexico	1,158	Nigeria	2,641	Norway	6,238	Malaysia	23,808
	All Country Total	252,274	All Country Total	398,873	All Country Total	857,907	All Country Total	2,296,497

Source: Bureau of Economic Analysis.
**Destination = affiliate sales to third markets and sales to U.S. for majority-owned foreign affiliates.*

A launchpad for U.S. companies
10 European countries in top 20 global export platforms

Table 3 underscores this point. The figures show U.S. affiliate sales to other destinations, or the exports of affiliates per country. Ireland is the number one export platform for U.S. affiliates in the entire world, reflecting the country's attraction as a strategic beachhead for U.S. multinationals hoping to penetrate the larger European market.

Ireland ranked well down the list 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 2016 to $293 billion. U.S. firms leverage Ireland as an export base to a far greater degree than low-cost locales like Mexico, Hong Kong and China. U.S. affiliates export five times more from Ireland than from China and almost four times more than from Mexico, despite strong NAFTA linkages.

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. Moreover, the UK decision to leave the EU may further solidify Ireland's spot as the number one location for U.S. affiliate exports if companies decide to relocate operations to Ireland in search of easier access to the EU market. Brexit may generate additional uncertainties, however, further underscoring Ireland's huge stakes in the outcome of the Brexit drama.

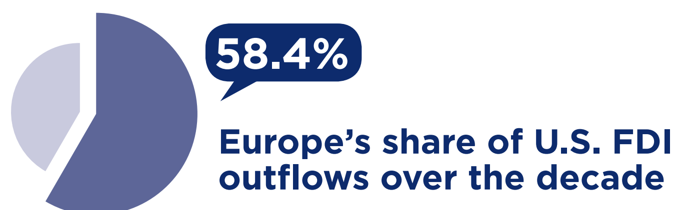
Of the top twenty global export platforms for U.S. multinationals in the world, ten are located in Europe, a trend that reflects the intense cross-border trade and investment linkages of the European Union and the strategic way U.S. firms leverage their European supply chains. Switzerland, ranked third, remains a key export platform and pan-regional distribution hub for U.S. firms.

The UK still plays an important role for U.S. companies as an export platform to the rest of Europe. The exports of U.S. firms based in the UK to the rest of Europe are greater than the exports of U.S. firms based in China to the rest of the world. However, the introduction of the euro, the Single Market and EU enlargement have enticed more U.S. firms to invest directly in continental member states of the EU. 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. Additionally, the ongoing Brexit saga has many implications for the strategy of U.S. firms when it comes to investment in different European countries.

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 of 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 to 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 23.5% of world output in 2018, according to estimates from the International Monetary Fund. Even when the United Kingdom is excluded from the figures, the aggregate output of this group of nations – $17.1 trillion, or 20.2% – is among the largest in the world. The figure (EU excluding the UK) is slightly less than America's share (24.2%), but in excess of China's – 15.9%. Based on purchasing power parity figures, the European Union's share, including Norway, Switzerland, and Iceland, was greater than that of the United States, but slightly less than that of China in 2018.

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



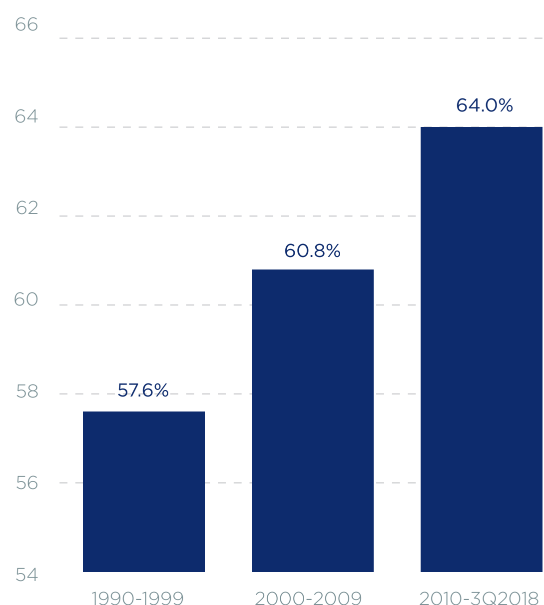
is now an economic behemoth of 28 member states joined together in a Single Market. Even with the UK's decision to leave the EU, the sum of Europe's parts is one of the largest economic entities in the world; as such, Europe remains a key pillar of the global economy and critical component to the corporate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

Table 4 Cumulative U.S. FDI Outflows ($Millions)

Decade	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	465,337	53.5%
2000-2009	2,056,009	1,149,810	55.9%
2010Q1-2018Q3	2,358,055	1,377,570	58.4%

Source: Bureau of Economic Analysis.

Table 5 U.S. FDI Flows to Europe
(% of World Total*)



**Excluding Caribbean and Other Western Hemisphere.*
Source: Bureau of Economic Analysis.
Data as of January 2019.

As Table 4 highlights, Europe attracts more than half of U.S. aggregate FDI outflows. The region's share of total U.S. FDI this decade is 58.4%, 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 climbs even higher, to almost two-thirds of U.S. direct investment.

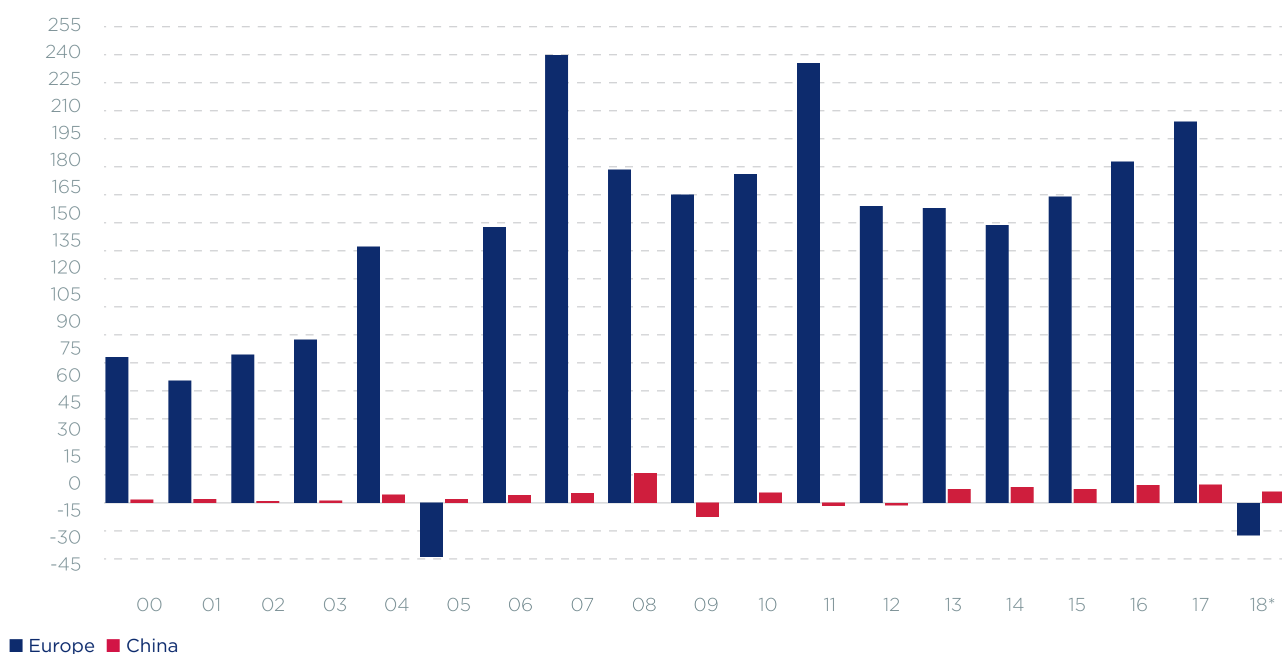
Even after adjusting for FDI flows related to holding companies, Europe remains the favored destination of U.S. firms (see Box 2 on holding company flows). This runs counter to the fashionable narrative that Corporate America prefers low-cost nations in Asia, Latin America and Africa to developed markets like Europe. Reality is different for a host of reasons.

First, investing in emerging markets such as China, India and Brazil remains 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. Although both Russia and Brazil have emerged from recession, growth is still projected to remain relatively weak in 2019. Growth prospects in China, meanwhile, have slowed considerably as Beijing shifts towards more consumption and service-led growth and away from export- and investment-driven growth. India's economy is on the rebound but poor and too closed off to make much of a difference to the bottom line of Corporate America. In the end, for both cyclical and structural factors, the BRICs and the emerging markets remain difficult places to do business. Hence the wide divergence between U.S. FDI to the BRICs (Brazil, Russia, India, China) and U.S. FDI to Europe (See Tables 6 and 7).

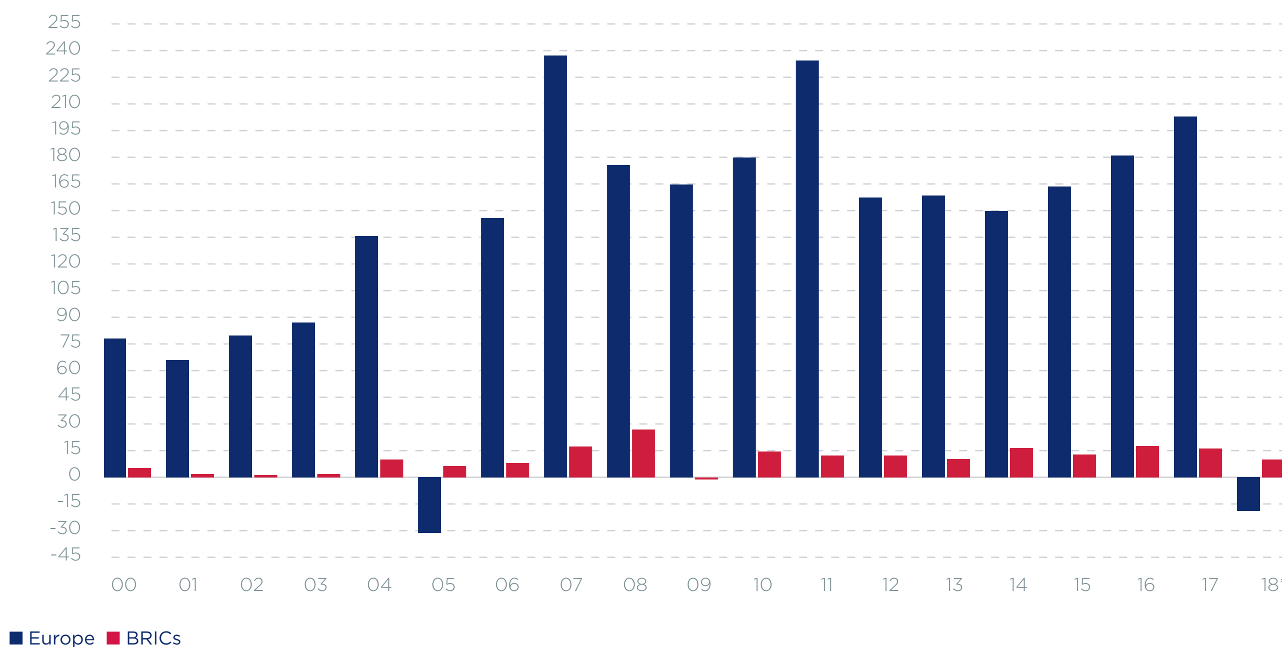
Third, while overall economic growth in Europe is moderating, there are pockets of the eurozone economy that are projected to grow rapidly in the near term. Ireland's growth rate for 2019 is estimated at 4%, while several other EU economies, such as Poland, the Czech Republic, Romania, and Hungary, are estimated to grow in the 3-4% range this year.

Table 6 **U.S. Foreign Direct Investment Flows to China vs. Europe** ($ Billions)



**2018 etimate based on 1Q-3Q data.*
Source: Bureau of Economic Analysis.
Data as of January 2019.

Table 7 **U.S. Foreign Direct Investment Outflows to the BRICs vs. Europe[1]** ($ Billions)



1 Europe does not include flows to Russia.
**2018 Estimate based on 1Q-3Q data.*
Source: Bureau of Economic Analysis.
Data as of January 2019.

Fourth, in addition to being 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. China's per capita income totaled just $8,827 in 2017, 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 ($53,442), the Netherlands ($48,223), Finland ($45,703), Germany ($44,470), and the European Union average of around $34,000. With a miserly per capita income of about $1,900, India ranks 142nd.

Wealth, in turn, drives consumption. The EU accounts for about 21% of total global personal consumption expenditures in 2017, a slightly lower share than that of the United States but well above that of China (10%) and India (3%) and the BRICs combined (18%). 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 too 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 European 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 2019 Ease of Doing Business rankings, 16 European economies ranked among the top 30 most business-friendly countries. Denmark ranked 3rd overall, followed by Georgia (6th), Norway (7th), the United Kingdom (9th), Macedonia (10th), Sweden (12th), Lithuania (14th), Estonia (16th), Finland (17th), Latvia (19th), Iceland (21st), Ireland (23rd), Germany (24th), Azerbaijan (25th), Austria (26th), and Spain (30th) (See Table 8).

Table 8 Ease of Doing Business 2018 Global Rankings

Ease of Doing Business 2019	
Rank	**Country**
1	New Zealand
2	Singapore
3	**Denmark**
4	Hong Kong
5	South Korea
6	**Georgia**
7	**Norway**
8	**United States**
9	**United Kingdom**
10	**Macedonia**
11	United Arab Emirates
12	**Sweden**
13	Taiwan
14	**Lithuania**
15	Malaysia
16	**Estonia**
17	**Finland**
18	Australia
19	**Latvia**
20	Mauritius
21	**Iceland**
22	**Canada**
23	**Ireland**
24	**Germany**
25	**Azerbaijan**
26	**Austria**
27	Thailand
28	Kazakhstan
29	Rwanda
30	**Spain**

Source: World Bank, Ease of Doing Business Report 2019.

Outliers include Italy, ranked 51st, Croatia, ranked 58th, and Greece, ranked 72nd. Meanwhile, reflecting the challenging business environment in many emerging markets, these countries rank low on the list. However, there are signs of improvement, with many of the major developing countries seeing their business rankings significantly increase in the past year. China ranked 46th in terms of ease of doing business in the latest rankings, up from 78th last year, while Brazil improved to the 109th spot after ranking 125th the prior year. India ranked 77th, moving up from number 100 last year and 130 in 2017. However, these nations still lag some of the developing countries in Europe. There is still much to be improved in terms of the regulatory environment in the BRIC nations; strong real GDP growth does not necessarily equate

to a favorable environment for business. Other factors need to considered, like the rise of state capitalism in many developing nations, 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.

Table 9 North Atlantic Economies are the Most Competitive in the World

Global Competitiveness Index 2018 Rankings	
Rank	Country
1	**United States**
2	Singapore
3	**Germany**
4	**Switzerland**
5	Japan
6	**Netherlands**
7	Hong Kong
8	**United Kingdom**
9	**Sweden**
10	**Denmark**
11	**Finland**
12	Canada
13	Taiwan
14	Australia
15	Korea
16	**Norway**
17	**France**
18	New Zealand
19	**Luxembourg**
20	Israel
21	**Belgium**
22	**Austria**
23	**Ireland**
24	**Iceland**
25	Malaysia
26	**Spain**
27	United Arab Emirates
28	China
29	**Czech Republic**
30	Qatar

Source: World Economic Forum, Global Competitiveness Report 2018.

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 ten more among the top thirty. Germany ranked 3rd, Switzerland 4th, the Netherlands 6th, the United Kingdom 8th, Sweden 9th and Denmark 10th (see Table 9). The United States, by way of comparison, ranked 1st.

At the other end of the spectrum, a handful of European nations scored poorly, underscoring the fact that Europe's competitiveness is hardly homogenous. Some nations did not even score in the top fifty – Bulgaria ranked 51st, Romania 52nd, Greece 57th, while Croatia ranked 68th in the latest survey, the worst performer among EU members.

The spread between third-placed Germany and floundering Croatia underscores the divergent competitiveness of the EU and highlights the fact that various nations exhibit various competitive strengths and weaknesses. For instance, Croatia's ranking was dragged down by a weak entrepreneurial culture, a large percentage of non-performing loans and poor labor market flexibility. Greece received low marks for its institutions and macroeconomic stability, which stands in contrast to Finland's strong protection of property rights and transparent institutions or Germany's healthy inflation and debt dynamics.

Belgium was cited for outstanding macroeconomic stability and utility infrastructure; France was highlighted for its research and development capability as well as its high life expectancy; Spain's ranking was hurt by labor market inefficiencies and worrisome public debt dynamics, but is the top country in terms of the overall health of its citizens. Switzerland ranked highly across many variables: quality of infrastructure, health of the labor market, innovation capability, and financial system stability, 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 European Innovation Scoreboard for 2018, Sweden, Denmark, Finland, the Netherlands, the UK, and Luxembourg rank as "innovation leaders" in

Number of researchers hosted
(2016)

1.9 million EU

1.7 million China

1.4 million U.S.

Europe. These are the most innovative states in the EU, performing well above that of the EU 28 average.

So-called "strong innovators" include Germany, Belgium, Ireland, Austria, France, and Slovenia. The performance of Croatia, Cyprus, the 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.

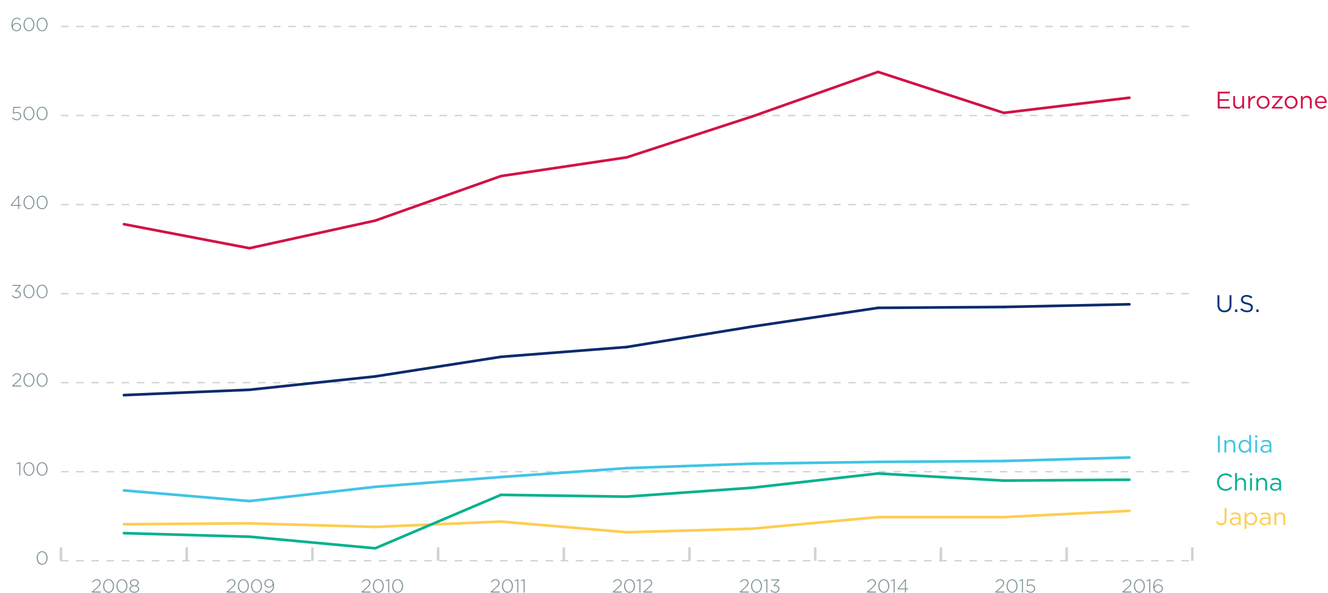
While significant discrepancies exist among nations in the EU as to knowledge-based capabilities, the innovation performance of the EU remains ahead of all BRIC nations. In addition, based on the latest figures from the innovation scoreboard, the EU is closing its innovation performance gap with the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

In that R&D expenditures are a key driver of value-added growth, it is interesting to note that Europe-based organizations accounted for 21.0% of total global R&D in 2017. That lagged the share of the United States (25.6%) but exceeded the share of Japan (8.8%), South Korea (4.1%), and India (3.7%). However, as of 2017, China is estimated to have outspent Europe in terms of R&D, with a 21.2% share. In 2017, the ratio of R&D-to-GDP was larger in Germany, Switzerland, Austria, and Denmark than in the United States.

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. Europe is among one of the world leaders in full time equivalent (FTE) research staff. Of the world's total pool of research personnel, the EU housed 1.9 million researchers in 2016 versus 1.4 million in the United States and 1.7 million in China, according to OECD estimates.

The EU is a global leader in high-technology manufacturing industries such as pharmaceuticals, scientific instruments and aerospace. Also, the EU is the largest exporter of commercial knowledge-intensive services (excluding intra-EU exports), which includes communications, business services, financial services, telecommunications, and computer and information services (See Table 10).

Table 10 Commercial Knowledge-Intensive Services Exports, Selected Countries ($ Billions)



EU exports do not include intra-EU exports.
Sources: World Trade Organization; National Science Foundation, Science & Engineering Indicators 2018.

Finally, in terms of future workers, Europe is home to one of the most educated workforces in the world. The share of the working age population with a bachelor's degree or higher in Switzerland is the highest in the OECD, at 43%. The comparable figures for Lithuania, Belgium, Iceland, Luxembourg, Ireland, and the UK are all higher than that of the United States (currently 35%).

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

Given all the above, Europe remains a key destination for U.S. multinational companies looking to expand their global footprint. The region remains large, wealthy, richly endowed, open for business, and an innovation leader in many key global industries.

Despite a slight moderation in growth expected in the immediate term, in the long run Europe is expected to 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 tripolar lens—a world encompassing the Americas, Europe and Asia, along with attendant offshoots. In this tripolar world, U.S. companies are not about to give up on or decamp from one of the largest segments of the global economy.

Box 2. U.S. FDI Outflows to Europe Adjusted for Flows of Holding Companies

For the past few years, we have highlighted the role of U.S. holding companies in determining U.S. investment flows to Europe. This additional lens is warranted since holding companies have accounted for a growing share of total U.S. FDI outflows to Europe over the years. 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 2017, the last year of available data, nonbank holding companies accounted for $127 billion, or about 42% of global U.S. FDI of $300 billion, and 51% of total U.S. foreign direct investment to the European Union of $164 billion. As the U.S. Bureau of Economic Analysis (BEA) 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. The countries attracting the most investment of holding companies, not surprisingly, are those with some of the lowest corporate tax rates in Europe, such as Luxembourg, the Netherlands, the UK and Ireland.

Tables 11a and 11b, drawing on BEA data, reflect the significance of holding companies in the composition of U.S. FDI outflows. European markets have accounted for roughly 56% of total U.S. FDI outflows since 2009. However, when flows to nonbank holding companies are excluded from the data, the share of outflows to markets such as Europe and Other Western Hemisphere declines.

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 BEA. Nonetheless, Europe remains the top destination of choice among U.S. firms even after the figures are adjusted. Between 2009 and 2017, Europe still accounted for over 47% 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 U.S. and Europe.

Table 11a **Total U.S. FDI Outflows, 2009-2017**
(% of Total)

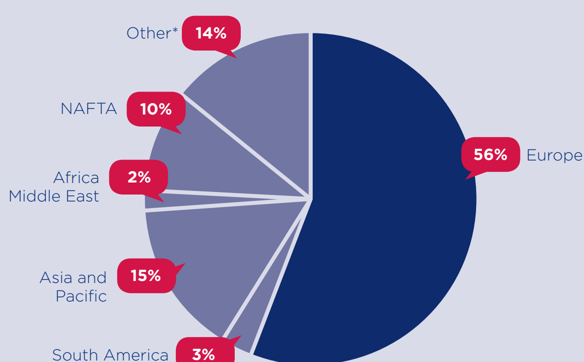
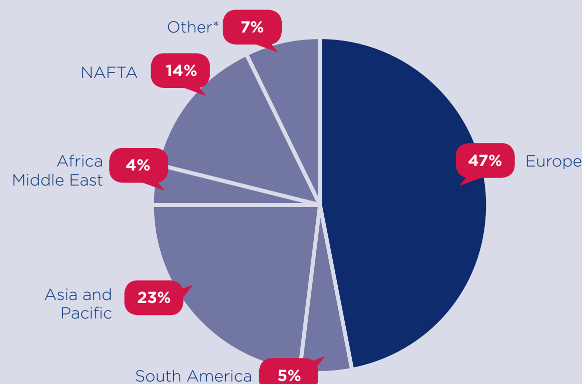


Table 11b **U.S. FDI Outflows Excluding Flows to Nonbank Holding Companies, 2009-2016**
(% of Total)



**Includes Central America (excluding Mexico) and Other Western Hemisphere.*
Source: Bureau of Economic Analysis.
Data as of January 2019.