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It’s still the Atlantic, stupid!

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„In Berlin many believe that China is Europe’s most important commercial partner. That is not true“

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Spending time in Germany this year I have been struck by repeated assertions by German government representatives that China has become Europe’s top commercial partner. These statements are usually made by pointing to sizable bilateral trade in goods.

There is no doubt that Europe’s stake in commercial ties with China are on the rise. But that does not mean that China is the country most important to the health of the German economy. Reducing complex commercial ties to one metric – trade in goods – ignores the commercial importance of investment links, services, digital connections, innovation ties and foreign sources of “onshored” jobs for the German and European economies. On each of these other metrics the ties that bind Germany and Europe to the United States are much thicker and far deeper than those with China.

U.S. exports of goods to the EU totaled $337 billion in 2019, up 6% from 2018 and more than three times larger than U.S. goods exports to China ($107 billion in 2019). U.S. goods imports from the EU were even larger, $515 billion in 2019. 2019 figures for trade with China are not yet available, but in 2018 the EU exported €351.2 billion in goods to the US and €210 billion to China. The EU imported €213.4 billion in goods from the US and €395 billion from China. That means that total EU-China trade in goods of €605 billion was roughly €40 billion more than EU-US trade in goods.

Keying in on this single metric, on March 6 the *Statistisches Bundesamt* issued a bald statement that “China was Germany’s largest trading partner in 2019 for the fourth year running.” Strangely, the professional numbers counters only counted trade in goods. They omitted trade in services – the fastest growing segment of the global economy. In short, Germany’s official statisticians got it only half right, and therefore all wrong.

In 2017, the last year of available data, the EU exported €236 billion in services to the United States and €42.6 billion to China. It imported €223 billion from the United States and imported €30.2 billion from China. That means that total EU services trade with the US was €469 billion and only €72.8 billion with China.

Here's the reality: the United States and Europe are the largest services economies in the world. They are each other's largest services market, and dense transatlantic services linkages mean that the transatlantic services economy is the geo-economic base for the global competitiveness of U.S. and European services companies. Europe accounted for 38% of total U.S. services exports and for 42% of total U.S. services imports in 2018.

In short, if you put trade in goods and services together, then it is clear that the largest trading partner for Germany and the EU overall – not for four years, but for many decades – is actually the United States.

Moreover, this is just the beginning of the story. Most German and European companies actually prefer to deliver services via their investment ties rather than through exports. Sales of services by European companies based in the United States of $585 billion in 2018 were more than double European services exports to the US in the same year. Similarly, sales of services by U.S. companies based in Europe of $882 were 2.5 times larger than U.S. services exports to Europe. And all of this dwarfs the relative miniscule sales racked up in China by U.S. and European companies, due to the many restrictions imposed by the Chinese on Western companies.
These numbers highlight an additional reality: trade alone is a misleading benchmark of international commerce. The real backbone of Germany's international economic standing is investment, not trade. And here again, the U.S. is Europe's primary source and destination for foreign direct investment. Europe plays the same role for the United States. China plays a marginal role in comparison.

In 2018 the U.S. and Europe together accounted for 58% of inward stock of foreign direct investment (FDI) and 63% of outward stock of FDI. Moreover, each partner has built up the great majority of that stock in the other economy. Europe accounted for about 60% ($18 trillion) of total U.S. global assets in 2018. The U.S. in turn, accounted for 62% ($8.1 trillion) of Europe's non-European assets around the world. Despite Donald Trump's bluster, the United States is the most important single market in the world for German business: German investment flows to the United States grew 54% in the first three quarters of 2019.

An inordinate fixation on trade in goods ignores the reality that most German and European companies prefer to deliver goods and services by investing in other countries, so to be close to their customers, rather than sending items across the ocean. Sales by European companies based in the United States in 2018, for instance, were more than triple European exports to the United States. Sales by U.S. companies based in Europe, in turn, were roughly one quarter larger than the comparable U.S. sales throughout the entire Asian region. Sales in Germany alone were over two-thirds larger than combined U.S. sales in Africa and the Middle East.

Despite the headlines about U.S.-European trade wars, U.S. and European companies also earn their money on each side of the Atlantic, not in China. In 2019, U.S. affiliate income in Europe rose to a record $295 billion and European affiliate income earned in the United States in 2019 was also at a record $140 billion. Over half of the income U.S. companies earn abroad comes from Europe. That is roughly three times more than what U.S. companies earn in all of Asia.

Europe accounted for 68% of the total $4.3 trillion of foreign capital sunk in the United States as of 2018. Total European stock in the United States of $3.0 trillion was four times the level of comparable investment from Asia. Germany's total FDI stock in the United States totaled $324 billion in 2018. Similarly, measured on a historic cost basis, the total stock of U.S. FDI in Europe was $3.6 trillion in 2018, or 61% of the total U.S. global investment position. This is more than four times the amount of comparable U.S. investment in the entire Asia-Pacific region. Moreover, Europe's share of total U.S. FDI is going up, not down -- 57.5% over the past decade. And 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 flows.

All of these facts run counter to the fashionable narrative that U.S. and European companies prefer China or other low-cost nations to developed markets. Reality is different.

First, investing in Europe or the United States is relatively easy, while investing in China remains difficult, due to onerous restrictions on foreign ownership and forced technology transfer rules. Second, growth prospects in China have slowed considerably, not only because of the coronavirus but because Beijing has shifted towards more consumption and service-led growth and away from export- and investment-driven growth. Third, while overall economic growth in Europe has downshifted in recent years, there are pockets of the eurozone economy such as Poland that are projected to have more robust growth in the near term. Fourth, in addition to being two huge markets, the U.S. and Europe are wealthy, which is correlated with highly skilled labor, rising per capita incomes, innovation, and a world class R&D infrastructure, among other things. Together the US and Europe account for half of global consumption, and gaining access to wealthy consumers is among the primary reasons why U.S. and European firms invest in each other's market.

Deep and thickening transatlantic investment ties contrast starkly with foreign direct investment coming to each continent from China. For some years Chinese FDI in both the United States and Europe soared from a relatively low base. However, Chinese investment is now plummeting on both continents, due to bilateral commercial tensions and tighter U.S. and European scrutiny of such investments. Chinese investment flows to the U.S. declined to approximately $4.5 billion in 2019 and Chinese FDI in Europe fell by 40% in 2019 to $13.4 billion. The pipeline of announced deals also suggests that 2020 will be a year of weak Chinese investment in North America and Europe.

The fact that U.S. investment in Europe dwarfs Chinese investment in Europe also means that U.S. companies are far more important sources of "onshored" jobs. In fact, despite the general impression that many US or European companies largely go abroad in search of cheap labor in places like China, the reality is that most foreign workers employed by American companies are European, and most foreign workers employed by European companies are Americans. American companies in Europe directly employed close to 5 million workers last year – a third more than in 2000. European companies in the US directly employed about 4.8 million workers. That underestimates additional employment generated by European exports to the US, the entire services sector, and the indirect employment effects for distributors and component manufacturers all along the supply chain.

As the globalization of research and development has gathered pace, more and more global R&D expenditures are emanating from Asia in general, and China in particular. Nonetheless, the United

States and Europe remain primary drivers of global R&D, and bilateral U.S.-EU flows in R&D are the most intense between any two international partners. In 2017, the last year of available data, U.S. affiliates spent $33 billion on research and development in Europe -- roughly 58% of total U.S. R&D globally. Moreover, R&D expenditures by U.S. affiliates were the greatest in Germany ($8.1 billion). European affiliates, in turn, spent $30.8 billion on research and development in the United States, accounting for 70% of total foreign R&D spending in the United States. German companies accounted for one of every five research dollars invested in the U.S. economy from abroad. Needless to say, these figures dwarf both US and European R&D investments in China.

Finally, the transatlantic economy is also the fulcrum of global digital connectivity. North America and Europe generate approximately 75% of digital content for internet users worldwide. Transatlantic flows of data continue to be the fastest and largest in the world, accounting for over one-half of Europe's data flows and about half of U.S. flows. 55% more data flows via transatlantic cables than over transpacific routes. In 2018 U.S. exports of digitally-enabled services to Europe were double U.S. digitally-enabled services exports to the entire Asia-Pacific region. Similarly, EU exports of digitally-enabled services to the United States alone were greater than EU exports of such services to all of Asia and Oceania.

An inordinate focus on trade in goods is deeply misleading. The health of the German economy and Europe's international competitiveness is not just dependent on this one particular segment of commerce, but on the many other ways Germany and its European partners are bound to others around the world. A fuller understanding of these forces make it clear that despite much talk of de-globalization and de-coupling, and siren calls of "America First" or "Europe First," the United States and Europe remain deeply intertwined and embedded in each other's markets, and that their respective links with each other – not China – remain the driver of the global economy.

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