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Transatlantic Policy Impacts of the U.S.-EU Trade Conflict

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Hearing by the
Subcommittee on Europe, Eurasia, Energy and the Environment
of the
Committee on Foreign Affairs
U.S. House of Representatives
June 26, 2019

Distinguished Members of the Committee,

Thank you for the opportunity to speak with you today about how U.S-European Union (EU) disputes over trade issues are affecting U.S. foreign policy and broader transatlantic economic relations.

Political volatility and economic uncertainty are testing the resilience and strength of the transatlantic economy – still the world's most significant commercial artery in the world and the one most important to both the United States and to Europe.

Trade tensions between the Trump Administration and the EU were coming to a boil until President Trump and European Commission President Jean-Claude Junker declared a "truce" in July 2018. While the two sides have agreed to re-launch bilateral trade negotiations, they have yet to agree on a common agenda, and each has very different goals in mind.

The Trump Administration is adamant about including agriculture in the negotiations, which the EU resists. It is trying to "cherry-pick" isolated wins without engaging in an ambitious effort such as the Transatlantic Trade and Investment Initiative (TTIP), which the Administration put in the deep freeze. If current talks stall, the Administration still holds open the possibility of invoking section 232 of the Trade Expansion Act of 1962 to move ahead with 25% tariffs on EU cars and auto parts – the same national security grounds the White House used to impose levies on foreign steel and aluminum, which prompted the EU to retaliate with duties on U.S. goods. U.S. auto-related tariffs would further inflame tensions, given that EU automotive exports to the United States are about 10 times greater in value than EU steel and aluminum exports combined. German companies, including their U.S.-based affiliates, would be the biggest losers: Germany alone accounts for 60% of Europe's $45 billion in annual exports of cars and parts to the United States. Germany is the largest European customer for 18 different U.S. states and the largest European goods supplier for 33 U.S. states.

The EU, in turn, is keen to include government procurement in the negotiations, which the Trump Administration resists. The EU wants to eliminate transatlantic tariffs on industrial goods and automobiles that President Trump is fighting to protect. The European Commission's approach is what I would call "rope-a-dope:" it wants to prolong the match so it can make it to the end of its term this fall without a trade war. President Trump has pledged not to impose auto duties as long as talks continue in good faith. But prospects of a quick agreement are slim. The EU tariff on imported cars is well above the comparable U.S. tariff (10% versus 2.5%). Extracting concessions from the EU without significant U.S. concessions in return will be difficult, especially if the U.S. refuses to include its 25% truck tariff (the U.S. might consider phasing out this tariff over 30 years as done in the United States–Korea Free Trade Agreement (KORUS) rewrite).

Consequences of U.S.-EU Frictions

If the Trump Administration imposes Section 232 tariffs on European cars, the EU will end the negotiations and impose tariffs in response, as it did with steel and aluminum, by identifying products that are politically sensitive in the United States, but which are readily substituted in the EU, in order to minimize any negative effects for European firms and consumers. The EU says retaliatory tariffs on imports from the United States would be worth about $23 billion. They would likely include U.S. agricultural exports, autos, chemicals and a host of manufactured goods, as well as services and public procurement contracts. Brussels would likely become more protectionist in a series of services activities. In addition, the EU's "rebalancing" tariffs on steel and aluminum were only about a third of the estimated value of the U.S. steel tariffs, so there is room for a more robust response in that area as well, without seeming to be disproportionate.

Not only would the economic scale of such a dispute be significantly greater than the irritation caused by the tariffs currently in place, a transatlantic trade dispute could easily spill over into national security issues, possibly damaging NATO and the broader transatlantic alliance.

A trade skirmish with the EU could spill over into a variety of other political actions. It would reduce to virtually zero EU political disposition to engage constructively with the United States on U.S. "asks" on seemingly unrelated issues. For instance, the EU could declare U.S. companies to be out of compliance with the EU-US Privacy Shield, ratchet up scrutiny of U.S. digital company activities, or consider other seemingly unrelated measures. Another example is the announcement of future visa requirements for U.S. citizens, starting in 2021. While this is a long-standing issue related to lack of compliance of some EU states such as Poland and Romania not meeting U.S. minimums when it comes to visa holders actually returning to their countries of origin, the fact that the EU decided now to demonstrate a bloc-wide approach to the issue and impose reciprocal visa requirements on U.S. citizens is a sign that the political mood for accommodation is evaporating.

Another negative ripple could affect the energy relationship that is now budding across the Atlantic. U.S. energy exports to Europe have jumped dramatically, and the United States is primed to ship more energy to Europe for both economic and strategic reasons. Auto tariffs would dampen European enthusiasm for expanding its energy relationship with a partner upon which it would not feel it could rely.

A trade skirmish with the U.S. would also likely accelerate EU efforts to move ahead with free trade agreements with other nations and regions of the world, boxing the United States out of various markets in some cases. The EU has already been successful on this front, including deals with Japan, Mexico and others, and would likely seek to finalize arrangements with MERCOSUR, the African Union and other regional groupings in Asia.

Moreover, these tensions are unfolding in the context of a slowdown in global growth. Prospects of a global recession remain minimal: the Big Three – the United States, China and the European Union – are all expected to post positive real GDP growth this year, although growth rates will be down from the prior year. The key worry is not the economics associated with what could be a modest cyclical slowdown, but political instabilities that could confound efforts to manage a downturn.

The Trump team's primary target is China, not Europe. Yet Europe has not been able to escape the negative shocks from simmering U.S.-China trade disputes. One consequence of U.S. imposition of steel tariffs, for instance, was to divert steel from China and other countries to Europe, forcing the EU to impose its own set of restrictions.

Opportunity Costs

Not only is a U.S-EU trade skirmish likely to result in direct costs to American workers, farmers, taxpayers, consumers and companies who are reliant on healthy transatlantic commerce, it is also likely to generate opportunity costs in terms of possibilities missed to promote jobs and growth across the Atlantic, and to position the U.S. and European economies for 21st century challenges.

U.S.-EU tensions have tended to overshadow an important fact: the EU shares many U.S. frustrations with Chinese cybertheft, its assaults on intellectual property, forced technology transfers, poor implementation of its World Trade Organization (WTO) obligations, and its state-subsidized overcapacity in steel and potentially autos, robotics and other sectors of the economy. The EU also shares U.S. concerns about severe Chinese restrictions on investment by U.S., European and other non-Chinese companies in modern services, energy, agriculture and high-tech sectors. Together the U.S. and the EU are wary of growing investments by state-owned Chinese firms in Europe and the United States. Brussels has joined Washington and Tokyo in trilateral talks focused on the commercial challenges posed by China. Yet current U.S.-EU trade tensions have stopped the U.S. and the EU from harnessing their impressive joint leverage to persuade China to adjust its policies. More contentious U.S.-EU trade disputes would probably dash any prospect for U.S.-EU cooperation on China 5G and the case against Huawei.

Moreover, the world that created the original transatlantic partnership is fading fast. Each side of the Atlantic is facing daunting economic challenges at home and abroad. A prominent driver guiding the U.S. and the EU to initiate the TTIP was the realization that they needed to act more urgently to open transatlantic markets in ways that could position each partner, and both together, to succeed in a world of diffuse economic power and intensified global competition. The addition of four billion people to the globalized economy and the rise of other powers, together with recent Western economic turmoil, convinced U.S. and European decision-makers that the window of opportunity may be closing on their ability to maintain high labor, consumer, health, safety and environmental standards and to advance key norms of the liberal rules-based order unless they act more effectively together. That looming reality is even more likely today than it was some years ago. Yet we are dithering and distracted.

Perhaps the greatest long-term consequence of U.S.-EU trade conflict is that by squabbling with each other, instead of turning joint attention to these 21st century challenges, the United States and Europe are squandering the opportunity to maintain their position as rule-makers, and face the growing prospect that they could each become rule-takers in a world increasingly inhospitable to the basic rules-based mechanisms guiding the global economy from which both have profited so enormously.

America's Stake in Healthy Transatlantic Commerce[1]

A trade skirmish between the United States and the European Union could cause significant damage to jobs, investment, trade and the innovative capacity of both economies because of the dense interlocking nature of their commercial linkages. It could generate significant dislocation and disruption in many different U.S. states by affecting jobs, trade, investment and innovation.

[1] All figures and references are drawn from Daniel S. Hamilton and Joseph P. Quinlan, *The Transatlantic Economy 2019: Annual Survey of Jobs, Trade and Investment between the United States and Europe* (Washington, DC: Foreign Policy Institute, Johns Hopkins University SAIS, 2019).

The United States and Europe are each other's most important foreign market in the world -- notwithstanding the rise of many emerging countries, including China.

The transatlantic economy generates $5.5 trillion in total commercial sales a year and employs up to 16 million workers in mutually "onshored" jobs on both sides of the Atlantic. It is the largest and wealthiest market in the world, accounting for one-third of world GDP in terms of purchasing power and half of total global personal consumption.

Ties are particular thick in foreign direct investment (FDI), portfolio investment, banking claims, trade and affiliate sales in goods and services, mutual R&D investment, patent cooperation, technology flows, and sales of knowledge-intensive services.

The U.S.-EU partnership continues to drive global trade, investment and capital flows. Total sales of U.S.-based European companies and European-based U.S. companies are roughly double total sales between the U.S. and the Asia-Pacific region, over four times those with North American partners Canada and Mexico, and five times more than with South America, Central America and the Caribbean.

Moreover, for many U.S. and European companies, the transatlantic economy is the geo-economic base from which they can engage successfully in other parts of the world. The United States serves as a global export platform for many European car companies, for instance. U.S. services companies, in turn, use the scale offered by their dense investment linkages across the transatlantic economy to be globally competitive when it comes to offering services in other parts of the world.

Not by Trade Alone

Transatlantic trade still stands as the largest such relationship in the world, even when compared to America's trade ties with China. U.S. merchandise exports to Europe are over 2.5 times greater than U.S. exports to China. 45 of the 50 U.S. states exported more to Europe than China in 2017. California, Texas, Michigan, Illinois and Ohio each exported more than twice as many goods to Europe as to China. New York's exports to Europe were more than eight times those to China. Only the Pacific-oriented states of Alaska, Hawaii, New Mexico, Oregon and Washington sent more goods to China than Europe in 2017.

In addition, while the figures are significant, they actually underestimate Europe's importance as an export destination for U.S. states because they do not include U.S. state exports of services. This is an additional source of jobs and incomes for U.S. workers, with most U.S. jobs tied to services. Europe is by far the most important market in the world for U.S. services, and the U. S. consistently records a service trade surplus with Europe. Suffice it to say that if services exports were added to goods exports by state, the European market becomes even more important for individual states.

By destination, key markets in Europe for U.S. states include Germany, the United Kingdom, and the Netherlands. Germany is the most important European customer for 18 different U.S. states; The UK is the biggest European customer for 14 U.S. states, followed by Belgium for 5 states, and France and the Netherlands each for 4 states.

America's merchandise trade deficit with the EU reached an estimated $168 billion in 2018, a record high and a thorn in the side of a Trump Administration fixated on bilateral trade deficits. America's deficit with China was larger (estimated at $417 billion), although that will provide little ballast to U.S.-Europe trade negotiations.

America's expanding trade deficit with Europe will remain a constant source of tension between the two parties again this year. Yet it is a bad guide for policy.

There is a widespread tendency in political circles, by the media, among the broader public, and even by some in the business community to equate international commerce with trade in goods. By this reckoning, surpluses in goods trade are "good" and deficits are "bad." Yet trade deficits can arise due to factors other than trade, such as differing domestic growth, consumption or savings rates among countries. Equally important is a simple fact: trade in goods, as even trade itself, is a misleading benchmark of international commerce. This is especially true when it comes to the transatlantic economy.

The broad-based nature of U.S.-European commercial ties cannot be understood by looking at merchandise trade figures alone. While some may associate the EU's large trade surplus in goods with the United States as a key competitive advantage for Europe, there are several other modes through which global companies reach consumers. These include services trade broadly, as well as digitally-deliverable services in particular – both key U.S. strengths. U.S. companies also deliver goods and services to Europeans through U.S. affiliates operating in Europe. They also generate so-called "primary income" from their foreign affiliate earnings as well as from investment income earned in Europe.

Taking all of these factors into consideration leads to a more balanced view of transatlantic commerce. While the United States does run a large deficit in goods with the EU (-$153 billion in 2017), the U.S. surplus in services trade (+$51 billion) and primary income (+$108 billion) with the EU more than offsets the goods imbalance. U.S. primary income receipts from the EU were almost $400 billion in 2017, versus EU-based companies' profits and investment income of just $288 billion in the United States.

Investment Leads, Trade Follows

These figures underscore an essential point to understand the enduring strength and importance of the transatlantic economy: investment, not trade, drives U.S.-EU commercial relations. Europe invests more in the United States than do investors from any other part of the world. The U.S. also invests more in Europe than in all the other countries of the world combined. Mutual investment in the North Atlantic space is very large, dwarfs trade and has become essential to U.S. and European jobs and prosperity.

U.S. affiliates in Europe and European affiliates in the United States are among the largest and most advanced economic forces in the world. Their total output – nearly $1.3 trillion – was larger than the output of such countries as the Netherlands, Turkey or Indonesia. European-based affiliates of U.S. companies accounted for over half the output of U.S. affiliates worldwide, and more than double affiliate output in the entire Asia-Pacific region ($329 billion).

U.S.-based affiliates of European companies, meanwhile, accounted for nearly two-thirds of the roughly $911 billion that U.S. affiliates of foreign multinationals contributed overall to U.S. aggregate production.

For 2017 we estimate that U.S. foreign assets in Europe reached $16 trillion, close to 60% of the global total. America's asset base in Germany ($811 billion in 2016) was more than a quarter larger than its asset base in all of South America. America's asset base in Poland, the Czech Republic and Hungary (roughly $144 billion) was on par with Corporate America's assets in India ($141 billion). America's assets in tiny Ireland ($1.4 trillion) were light years ahead of those in China ($404 billion).

Europe's stakes in the United States also significant: total assets of European affiliates in the United States were valued at roughly $7.7 trillion in 2016, accounting for nearly 60% of all foreign-owned assets in the United States. Europe accounted for 68% of the total $4.0 trillion of foreign capital sunk in the United

States as of 2017. Total European stock in the United States of $2.7 trillion was four times the level of comparable investment from Asia. Europe is by far the largest source of foreign direct investment in America's manufacturing industry, accounting for 76% of the total. We estimate that Europe accounted for 60% ($136 billion) of the total $226 billion worth of global foreign direct investment flowing into the United States in 2018.

Here's another example of why a myopic focus on trade deficits in goods is so damaging to the American economy. In 2017 U.S.-based European companies recorded $2.5 trillion in sales – more than triple U.S. imports from Europe. European companies prefer to invest, produce, create jobs and sell in the United States rather than send goods across the ocean. American companies do the same: in 2017 European-based U.S. companies recorded $3 trillion in sales – more than total global U.S. exports of $2.4 trillion. Commercial conflict between the U.S. and Europe could chill European taste for investments in the United States, dimming prospects for local U.S. communities reliant on such inflows of money and innovation.

Investment and trade can be mutually reinforcing. Ireland – not Mexico or China -- 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. companies hoping to penetrate the larger European market. 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.

Jobs, Jobs, Jobs

These investments are a major reason why most foreigners who work for European companies in the world are Americans, and why most foreigners who work for American companies in the world are Europeans. Roughly two-thirds of all Americans who work for a foreign company in the United States work for European companies. On average these U.S. workers receive higher pay and better benefits than those working for domestic companies.

In 2017 we estimate that U.S. affiliates based in Europe directly employed about 4.81 million European workers, and European affiliates based in the United States directly employed about 4.59 million Americans. These figures understate the employment effects of mutual investment flows, since these numbers are limited to direct employment, and do not account for indirect employment effects on nonequity arrangements such as strategic alliances, joint ventures, and other deals. Moreover, foreign employment figures do not include jobs supported by transatlantic trade flows.

In sum, we estimate that the transatlantic workforce numbers some 14-16 million workers.

European firms can be found in all 50 states, and in all economic sectors – manufacturing and services alike. Given mounting labor shortages in the United States, many European affiliates have taken the lead in job training in the U.S., and have emerged as strong advocates and funders of vocational training.

Figures for jobs, trade and investment coming from Europe into each of the 50 U.S. states is available in our latest report, *The Transatlantic Economy 2019*, available at https://transatlanticrelations.org/wp-content/uploads/2019/03/TE2019_A_StateProfiles.pdf

As mentioned above, European employment is relatively diverse and spread across many U.S. states. The more European firms embed in local communities around the nation, the more they tend to generate jobs and income for U.S. workers, greater sales for local suppliers and businesses, extra revenues for local communities, and more capital investment and R&D expenditures for the United States.

Transatlantic Services

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 also the geo-economic base for the global competitiveness of U.S. and European services companies.

Transatlantic ties in services – both in trade and investment – are quite large and have become even more intertwined over the past decade. Transatlantic linkages continue to deepen in insurance, education, telecommunications, transport, utilities, advertising, computer and business services.

Europe accounted for 37% of total U.S. services exports and for 43% of total U.S. services imports in 2017. Four out of the top ten export markets for U.S. services in 2017 were in Europe.

Like with goods, trade figures, while significant, do not do full justice to the importance of the transatlantic services economy. Like goods, U.S. firms primarily deliver services in Europe (and vice versa) via their foreign affiliates rather than by trade. Transatlantic foreign affiliate sales of services are much deeper and thicker than traditional trade figures suggest. Indeed, sales of affiliates have exploded on both sides of the Atlantic over the past few decades thanks to falling communication costs and the rise of the digital economy. Sales of services of U.S. foreign affiliates in Europe in 2017 totaled $802 billion and have risen by more than 30% since 2009. U.S. services exports to Europe for the same year were $298 billion, well below sales of affiliates. On a global basis, Europe accounted for roughly 53% of total U.S. affiliate service sales.

In 2016, European affiliate services sales in the United States totaled $561 billion. European affiliates are the key provider of affiliate services in the United States, accounting for 56% of total foreign affiliate sales of services in the U.S. of $995 billion in 2016.

In the end, the U.S. and Europe each owe a good part of their competitive position in services globally to deep transatlantic connections in services industries provided by mutual investment flows. A good share of U.S. services exports to the world are generated by European companies based in the United States, just as a good share of European services exports to the world are generated by U.S. companies based in Europe.

Innovation Economies

The United States and Europe remain primary drivers of global R&D. Bilateral U.S.-EU flows in R&D are the most intense between any two international partners. In 2016, R&D spending by European companies based in the U.S. spent $44 billion on R&D, accounting for 73% of total foreign R&D spending in the United States, fueling America's innovation economy. U.S. affiliates spent $31.3 billion on research and development in Europe. Europe accounted for roughly 58% of total U.S. global R&D.

The transatlantic economy is the geo-economic base for the global competitiveness of many U.S. and European companies. About 60% of European exports to the United States consist of trade within the company, such as when BMW or Siemens of Germany sends parts to BMW of South Carolina or Siemens of North Carolina, or when Lafarge or Michelin send intermediate components to their Midwest plants. Those components are then often assembled into final products that are then exported from the United States to the rest of the world. U.S.-based affiliates of European companies accounted for over half of U.S. exports by foreign affiliates in 2016. In the end, the more European affiliates export from the United States, the higher the number of jobs for U.S. workers and the greater the U.S. export figures. For this reason, efforts to restrict investments or impose trade tariffs on these dense transatlantic linkages threaten to damage U.S. exports and diminish America's attractiveness as a destination for investment from Europe -- its prime trade and investment partner and its primary source of "onshored" jobs.

The Transatlantic Economy: The Hub of Digital Globalization

Another key to understanding America's stakes in healthy transatlantic commerce is to realize that the transatlantic economy is the fulcrum of global digital connectivity. North America and Europe generate approximately 75% of digital content for internet users worldwide. U.S. and European cities (Frankfurt, London, Amsterdam, Paris, Stockholm, Miami, New York, Marseille, Los Angeles, San Francisco) represent the world's foremost hubs for international communication and data exchange. Europe is the major market in the world for U.S. digital goods and services. According to McKinsey, as of 2015, cross-border data flows between the United States and Europe were by far the most intense in the world – 50% higher than data flows between the United States and Asia in absolute terms, and 400% higher on a per capita basis.

Digitally-enabled services account for an ever-growing share of U.S. and European services exports and services sales by U.S. and European companies based abroad. In addition, their transformative impact is not limited to just the services sector but extends to manufacturing and the traditional bricks-and-mortar economy as well. Digitally-enabled services such as consulting, engineering, software, design and finance are used in manufacturing industries such as transport equipment, electrical equipment and food products. In this regard, digitally-enabled services from the United States have become critical to the competitiveness of European manufacturing and retail operations, and vice versa.

Moreover, digitally-enabled services are not just exported directly, they are used in manufacturing and to produce goods and services for export. Over half of digitally-enabled services imported by the United States from the EU is used to produce U.S. products for export, and vice versa, thus generating an additional value-added effect on trade that is not easily captured in standard metrics.

In 2017, the United States registered a $172.6 billion trade surplus in digitally-enabled services with the world. Its main commercial partner was Europe, to which it exported $204.2 billion in digitally enabled services and from which it imported $123.7 billion, generating a trade surplus with Europe in this area of $80.5 billion, according to figures from the U.S. Bureau of Economic Analysis. U.S. exports of digitally-enabled services trade to Europe were 2 ½ times greater than U.S. digitally-enabled services exports to Latin America, and almost double U.S. digitally-enabled services exports to the entire Asia-Pacific region.

The United States, in turn, is the largest non-EU consumer of EU digitally-enabled services exports, accounting for more EU exports than the rest of non-EU Europe and more than all digitally-enabled services exports from the EU to Asia and Oceania ($165.4 billion).

The Importance of the Auto Industry

The auto industry is a key example of the strong trade and investment ties between the United States and Europe. Foreign auto companies are critical supports to the US economy in terms of employment, value added, exports, technological advancements, and, ultimately, America's productivity and competitiveness.

- *Employment:* European companies directly support 173,000 jobs in the U.S. motor vehicle and parts industry, or 42% of total foreign affiliate employment in this industry. This figure, however, only accounts for direct employment by affiliates and ignores the downstream effects that European auto manufacturing investment has had on other industries such as automotive dealers, parts suppliers, and research and development (R&D). Incorporating the larger downstream employment effects, the European Commission estimates that EU auto companies support around 420,000 U.S. jobs.

- *Production:* According to the European Automobile Manufacturers Association, EU auto companies produced roughly 2.9 million passenger cars in 2017, or 26% of total U.S. production. All totaled, European auto and parts companies contributed $34 billion towards America's gross domestic product (GDP) in 2016.

- *Exports:* European manufacturers not only produce vehicles for U.S. consumers, but also use the U.S. market as a key export hub to send their vehicles overseas. About 60% of European cars produced in the United States are exported to third markets, like China and the EU. Thus, trade tensions between the United States and China threaten an important source of demand for European automakers.

- *Innovation:* European auto companies that invest in the United States are also key contributors to the innovation and research culture that drives the U.S. economy. R&D expenditures by European affiliates in the U.S. auto industry reached a record $5.5 billion in 2016, or 12.5% of total European affiliate R&D spending.

While foreign direct investment (FDI) is the primary method of cross-border commerce in the auto industry, U.S.-EU trade ties are also significant, with auto-related trade representing 10% of total trade between the two regions. The United States was the largest global market for EU car exports in 2017, representing 29% ($45 billion) of total EU auto exports. Meanwhile, Europe was a significant purchaser of U.S.-produced vehicles, taking in 20% of total U.S. car exports.

The Impact of Brexit

Current uncertainties in transatlantic commercial ties could be exacerbated significantly as of this fall, when the UK is set to leave the EU. The vote to leave the EU in June 2016 has already cost the UK about 800 million pounds ($1 billion) per week (about 2% of total economic output). Ernst and Young expects a trillion euros in bank assets to flee the UK. U.S. foreign direct investment flows to the UK plunged by 31% in 2017 and by another 9.8% in the first nine months of 2018. The UK government itself estimated that under the terms of the 2018 UK-EU draft agreement – rejected by the British Parliament yet deemed the best deal the UK could expect by the EU – the British economy would shrink by 3.9% (a loss of £100 billion) by 2030. Without a deal, the Confederation of British Industry concluded that every part of the UK would pay an "unacceptable economic price." No matter what the Brexit terms may be, the process is likely to unsettle markets and cast a cloud over the UK's relations with the U.S. and key partners for many years.

America's economic stakes in the United Kingdom are among the deepest in the world. Totaling $748 billion in 2017, the last year of available data, America's capital stock in the UK is more than double the combined investment in South America, the Middle East and Africa ($253 billion) and seven times greater than U.S. investment stock in China ($108 billion in 2017). Even when the U.S. investment presence in China and India are combined – totaling $152 billion in 2017 – the figure is just 20% of total U.S. investment in the UK. Whatever the metric – total assets, R&D expenditures, foreign affiliate sales, employment, trade, etc. – the United Kingdom has been a longtime pillar of America's global economic infrastructure and a key hub for the global competitiveness of U.S. firms.

As Brexit unfolds, the United States has a vital stake in ensuring that each point in the transatlantic triangle -- U.S.-UK, UK-EU, and U.S.-Europe -- is strong and sturdy. Failure to ensure that these three elements are mutually reinforcing rather than mutually disruptive will shortchange American workers, American consumers, American companies, and American interests.

When the UK exits the EU, the UK government's Great Reform Bill will transform EU legislation into UK legislation. That will ensure initial consistency with current rules in the UK. But once the UK does leave the EU, it will assess whether it wants to continue with those EU-oriented rules or whether it wants to determine, and then implement, new and different regulations.

When the UK exits the EU it will also have to do three things that will affect U.S. economic interests.

First, it will have to replace the EU's common external tariff with its own customs tariff, and will also need to submit new tariff commitments for both goods and services at the World Trade Organization (WTO). These commitments must be agreed by consensus among the entire WTO membership -- 161 countries. If only one WTO member objects, the UK's schedule of commitments will be disqualified. The EU itself could block it. Russia could block it. China or India could block it. Some countries may be reasonable, others may seek to gain advantage at UK expense. All of this will take some time and preoccupy the UK's limited bench of trade negotiators.

The United States will be particularly keen to know how far the UK will be prepared to go in such areas as services or agriculture when it comes to trade with other WTO members. Until the UK's WTO commitments are known and agreed, our trade negotiators will not know the baseline for their own bilateral negotiations with the UK.

Second, the UK will negotiate new trade arrangements with the EU 27. A future UK-EU trade arrangement is unlikely to simply replicate the status quo in terms of UK access to the EU Single Market. The terms are likely to be less advantageous than if the UK were a member of the EU. While tariff-free access for goods is likely, firms based in the UK are likely to face some local content requirements within the EU. It is unlikely that there will be tariff-free access for services. UK financial services in particular are likely to lose their current right to "passport" financial services to the rest of the EU. Each of these provisions -- as well as related provisions to be negotiated during the transition period -- are likely to affect U.S. companies and banks with affiliates in the UK.

A new trading relationship between the UK and the EU will need to be approved by parliaments of all 28 current EU member states and by the European Parliament. Given the complicated issues and procedures involved, it is likely that such a new agreement would only take effect sometime in the middle of the next decade. This means there is likely to be a period of transition that could last as much as six years. Both parties will also have to negotiate trade and commercial arrangements for this transitional period. Such arrangements will not be subject to parliamentary approval.

Third, it will want to negotiate new trade arrangements with the United States as well as many other non-EU countries. EU rules mean that London cannot legally begin negotiating a trade deal with Washington before the UK leaves the EU, which at the earliest will be October 31, 2019. When Washington sets out to negotiate a formal bilateral deal with the UK, it will want to understand the UK's new WTO commitments and the nature of UK-EU transitional arrangements following Brexit, as well as London's end goals with regard to a deal with the UK's largest trade partner, the EU. This will all take time.

Washington and London have already been conducting what might be called "shadow" negotiations to identify potential stumbling blocks and scope out what create a basic framework might eventually look like.

What would be the major issues in a U.S.-UK deal? Agreeing on reductions in traditional trade tariffs is not likely to be very troublesome, since most tariffs are already quite small, with a few notable exceptions, such as agriculture. The much bigger gains from a bilateral deal would come from

- reducing barriers to services, the "sleeping giant" of the transatlantic economy and where job gains are likely to occur;

- recognizing that various regulatory procedures in one country essentially conform or are equivalent to those in the other country;
- pioneering standards in new economic areas that could push the global frontier.

Keeping in mind that both the U.S. and the UK have more to gain from achieving some agreement with the EU than simply with each other, each should want to ensure that whatever agreements they reach with each other serve to strengthen, rather than disrupt, their more significant commercial connections with the EU. Similarly, the EU will want to ensure that a U.S.-UK agreement, as well as any separate arrangements it may advance with the U.S. and with the UK, will enhance its own economic ties with two of its most significant economic partners.

A U.S-UK agreement could be harder than some anticipate. Disagreements are likely to arise over differences in regulatory policy. Issues such as public procurement and healthcare have strong public constituencies and are often extremely sensitive. Remaining tariff barriers, especially in agriculture, often reflect the most politically difficult cases. It is unclear, for instance, whether UK farmers will be keen on a trade deal that would open them up to U.S. competition at the very time they are losing generous EU subsidies, or whether they will be willing to accommodate U.S. interests in changing their rules related to hygiene or genetically-modified organisms if that makes it harder for them to sell to the EU, which is their largest market.

The benefits, however, could be considerable, and important to many constituencies across the United States.

U.S.-EU: Possible Ways Forward

For decades the partnership between North America and Europe has been a steady anchor in a world of rapid change. Today, however, the transatlantic partnership itself has become unsettled and uncertain. Nowhere is this clearer than in the economic sphere.

This state of division and mutual inwardness threatens the prosperity and ultimately the position of North America and Europe in the global economy and the broader global security system.

Previous efforts to harness the potential of the North Atlantic economy have foundered for a variety of reasons. Nonetheless, the strategic case for an upgraded and updated transatlantic economic partnership is more compelling than ever.

Opportunities may still be within reach. Four paths seem plausible.[2]

The Road We Are On: Transatlantic Zero

The notional goal of current U.S.-EU negotiations would be to remove all U.S.-EU tariffs on industrial goods (Transatlantic Zero), reduce non-tariff barriers and subsidies on industrial goods, and to reduce barriers to services.

[2] For more, see Daniel S. Hamilton, *Creating the North Atlantic Marketplace for Jobs and Growth: Three Paths, One Detour, A U-Turn, and the Road to Nowhere* (Washington, DC: Center for Transatlantic Relations, 2017), https://transatlanticrelations.org/wp-content/uploads/2018/09/Creating-a-North-Atlantic-Market-Place-by-Daniel-S.-Hamilton.pdf

Since many of these barriers are relatively low, skeptics wonder about the benefits of going to "transatlantic zero." But given that many U.S. and EU exports in the end result from many different intermediate imports, and that related-party trade, or trade among affiliates of the same company, is so important in transatlantic commerce, even relatively low tariffs can have multiple knock-on effects all down the value chain, potentially cutting the cost of production and lowering prices for consumers.

Moreover, given the size of the transatlantic economy, even small changes can have big effects on jobs and growth. Freer transatlantic trade without tariffs and with lower technical barriers could translate into millions of new jobs across the North Atlantic space and improve both earnings and competitiveness for many companies, particularly small- and medium-sized enterprises.

On the face of it, achieving a “Transatlantic Zero” deal may not be that hard. When TTIP negotiations paused in January 2017, negotiators had already exchanged offers to eliminate duties on 97% of tariff lines, a large majority of which would be phased out immediately upon entry into force of the agreement or phased out quickly.

Despite current U.S. and EU rhetoric supporting this approach, at least five issues render the chances for an agreement low, at least through 2020.

First, it is unclear how a negotiation to achieve Transatlantic Zero solely on industrial goods would be compatible with WTO rules that mandate that trade agreements must include “substantially all trade.”

Second, France insists that EU trade agreements can only be concluded with partners who are signatories to the Paris Climate Agreement, from which the United States has withdrawn. France also did not support giving the European Commission the mandate to begin negotiations. It was overruled, but its support will be crucial in any endgame.

Third, the political window for a deal has essentially closed for this year. The current European Commission’s mandate expires this fall.

Fourth, each side wants to exclude the economic sector that is perhaps of most interest to the other: Brussels doesn’t want to include agriculture, and Washington doesn’t want to include government procurement. In addition, the auto sector has become a particularly contentious issue, and the chances for a breakdown are high.

Fifth, the type of deal being discussed, if implemented, is unlikely to do much to narrow the U.S. bilateral merchandise trade deficit with the EU, which ostensibly is President Trump’s primary concern.

The Road to Nowhere: The Deep Freeze

Should current talks falter, it is tempting simply to keep transatlantic negotiations in the deep freeze. The obstacles seem too high, and the incentives too low, for either side of the Atlantic to invest much political capital in any major transatlantic economic initiative. Yet unresolved trade, tax and privacy issues are more likely to fester than remain frozen. Washington and Brussels will be distracted and diminished by their trade squabbles as China rises. The WTO itself could be at risk. Economic anxieties and political prejudices will be exacerbated. The result is likely to be a downward spiral of mutual recrimination. It would be more than drift; it would mean accelerating protectionism, U.S.-EU rivalry in third markets, and the triumph of lowest-common-denominator standards for the health, safety and welfare of Americans and Europeans alike. Standing still means losing ground. The Deep Freeze may be the path of least resistance, but it is the road to nowhere.

The Regulatory Road

If the will is there (a very big if), both sides could gain considerably from closer regulatory cooperation. Given that tariffs on average are quite low across the Atlantic, more is likely to be gained economically through mutual recognition of essentially equivalent norms and regulatory coherence than through tariff reductions.

Through TTIP U.S. and EU officials already

- found common ground on a number of important good regulatory practices;
- made good progress in developing approaches for facilitating forward-looking regulatory cooperation in areas of common interest;
- identified possible mechanisms for reducing unnecessary burdens in transatlantic trade arising from redundant or duplicative product testing and certification requirements;
- negotiated provisions that would facilitate trade subject to sanitary and phytosanitary import checks; and
- explored in detail ways to enable stakeholders to participate more fully in the development of product standards across the Atlantic, and how to take into account those standards.

Critics may charge that the prospect of such agreements between the Trump Administration and the EU would be low. Yet the two parties have already shown they can strike such deals, most recently on drug regulations and on insurance. In each of these areas, each side has shown a capacity to reach an agreement that improves efficiencies, reduces costs, and facilitates transatlantic commerce without challenging basic precepts of sovereignty. Neither agreement compels either party to adopt the other's system. Neither imposes exactly the same regulation on both sides of the Atlantic. Rather, each reflects the belief of the respective regulators, supported by evidence, that the quality of drug inspections, or the level of consumer protection regarding insurance, is substantially equivalent in the EU and in the United States.

Other sectors show similar promise for U.S.-EU agreement: automotive safety regulations; unique identification of medical devices; fiber names and labelling, safety requirements, and conformity assessment procedures in the textiles sector; cosmetics; pesticides; chemicals; information and communications technology; engineering; and technical barriers to trade. A paper circulated by the European Commission among EU member countries marine equipment, car safety, pharmaceuticals, and medical devices, and new technologies (such as electric cars, robotics and cybersecurity) as areas in which the two economies could develop more regulatory cooperation. Food safety is also mentioned, although with big caveats on the need to maintain EU standards. The paper also lists areas where testing procedures between the EU and U.S. are similar enough that both the EU and U.S. could recognize each other's regulations as acceptable without re-testing.

The two sides could initiate workstreams in which officials could chip away at workaday issues and seek to capitalize on progress that had been achieved both within and outside the TTIP framework. The U.S.-EU High Level Regulatory Cooperation Forum (HLRCF), established in 2005, could be revived to allow regulators themselves to promote best practices in such cooperation.

Regulatory cooperation need not mean that the U.S. or the EU would "harmonize" laws. A range of possibilities are possible, for instance

- agreement on principles and best practices in domestic regulation (sometimes referred to as 'regulatory coherence');
- general (or 'horizontal') provisions governing regulatory cooperation;
- sharing of safety or other data; and
- provisions on how such regulatory cooperation should relate to third parties.

U.S.-EU regulatory cooperation also need not take the form of a trade agreement. Rather, a political statement of principles could essentially frame a series of regulator-to-regulator agreements, each tailored to the specific nature of their particular regulatory sphere. Such understandings could also be advanced within international organizations, like the UNECE for car standards.

Such an approach would not hold trade and regulatory issues hostage to one another. Regulator-to-regulator agreements could proceed without waiting for the many details of a trade agreement to be nailed down. Similarly, trade liberalization would not need to be delayed until regulatory processes unfolded.

The U.S. and EU might consider a framework document to move this initiative forward. Regulatory agencies do not necessarily need an overarching document to reach accords with other regulators; U.S. and EU regulators, for instance, have signed over 20 such agreements. But a framework document could provide direction to that cooperation and give it a higher political profile without undermining regulatory processes.

Regulatory cooperation may lead to less need for duplication of testing, less adjustment needs for different markets, fewer contradictory technical requirements and overall save producers large unnecessary costs – without lowering levels of protection. Over time, case-by-case agreements in these areas would build a significant transatlantic 'acquis' that would influence and perhaps even set the bar for regulatory officials in many other areas of the world. Moreover, if regulators have evidence demonstrating that their transatlantic counterparts are able to enforce levels of protection similar to their own, they can develop a partnership with that counterpart regulator, allowing them to focus their limited enforcement resources on higher-risk problems emanating from other areas of the world. [3]

Washington and Brussels could also cherry pick other non-trade wins, both by looking at possible low-level executive or inter-agency agreements that are "under the radar" of high-level political attention, and at promising elements from the TTIP negotiations. For example, both sides have already identified steps to reduce unnecessarily burdensome requirements and delays at each other's borders. They already negotiated a dedicated chapter focused on small and medium-sized enterprises, which, among other things, could help small and medium-sized enterprises better navigate the transatlantic marketplace through the provision of enhanced online information and new mechanisms for U.S.-EU cooperation. They also already agreed on the importance of transparency and due process in trade remedy procedures and competition policy; public affirmation of these principles would be reassuring at a time of economic uncertainty and tension.

The Road Not (Yet) Taken: TTIP 2.0

The Trump Administration abandoned TTIP upon entering office, even though the negotiations were almost finalized. Simply continuing TTIP runs headlong into significant differences in political priorities between the Trump administration and EU governments. And unless modified, it would be likely to reinforce, rather than assuage, public anxieties about the effects of transatlantic regulatory harmonization and investor-state

[3] The United States imports around 90% of its seafood, for instance, most of it from Asia, but only 2% of it is inspected. See United States Government Accountability Office, "Food Safety: Additional Actions Needed to Help FDA's Foreign Offices Ensure Safety of Imported Food," Report to the Chairman, Subcommittee on Europe, Eurasia, and Emerging Threats, Committee on Foreign Affairs, House of Representatives, January 2015, available at http://www.gao.gov/assets/670/668230.pdf.

dispute provisions. It does not address Brexit or the importance of including other North Atlantic partners beyond the United States and the European Union. A modified TTIP that took account of such concerns, however, remains the path offering the greatest potential economic impact for both economies, and could equip each side of the Atlantic with greater leverage with regard to global competition. TTIP 2.0 would not be just another free trade agreement, it would pioneer new ways the two major democratic actors in the global economy could address costly frictions generated via their deep commercial integration by aligning regulations, opening services, and setting benchmarks for high-quality global norms and rules. Given strong political headwinds, however, the TTIP path may have run out of road.

Each of these paths has its pros and cons. The time to choose may not yet be at hand. But it is coming soon. The transatlantic relationship has entered a period of estrangement; trade and investment ties remain thick, but fragile, and are eroding with each passing month. The U.S.-European partnership is too big and too important to fail.

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Appendix [4]

European-Sourced Jobs, Trade and Investment in the 50 U.S. States

[4] Figures are drawn from Daniel S. Hamilton and Joseph P. Quinlan, *The Transatlantic Economy 2019: Annual Survey of Jobs, Trade and Investment between the United States and Europe* (Washington, DC: Foreign Policy Institute, Johns Hopkins University SAIS, 2019).