The Transatlantic Economy:

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before the

Subcommittee on European Affairs
Senate Foreign Relations Committee

Wednesday, December 9, 2009

Madam Chairwoman, Senator deMint, other distinguished members of the Subcommittee, thank you for this opportunity to appear before you to discuss this important topic. I am honored. I truly welcome your interest in a subject — the transatlantic economy — that is often ignored but is a vital part of U.S. prosperity. Moreover, this interest is especially timely, as there are now opportunities to deepen the transatlantic economic relationship and take on a key role in leading the global economy away from the financial crisis.

The transatlantic economy — the combined market of the United States and the European Union — is the core of the global economic system. Even after the financial crisis, the United States and the EU together comprise 54 percent of global GDP. Their markets represent mature, service-oriented economies that have been the major engines for innovation in both markets and technology for the last few decades. And because of the size and attractiveness of their markets, the United States and the EU (along with its member states) play a major role in shaping global standards and regulations.

Recently, much of the policy community has been focused on China as an economic partner of the United States. While China is clearly an increasingly important member of the global economy, along with a number of other emerging economies, the reality is that China's economic interactions with the United States are generally not of the same magnitude as those of the EU. In terms of trade, for example, China imported $85 billion worth of goods and services from the United States in 2008, and exported $348 billion. That same year, the EU as a whole (and the EU is a single trading zone) imported $467 billion in goods and services from the U.S. and exported $521 billion. And while the U.S. trade deficit with China totaled $262 billion, the trade deficit with the EU was $54 billion. The U.S.-EU investment relationship is even more dominant. In 2008, U.S. EU investment into the United States totaled $1.4 trillion, or just over 60 percent of all foreign investment in the U.S. U.S. investment in the EU totaled $1.6 trillion, or 51 percent of U.S. investment abroad. That same year, U.S. investment in China totaled only $46 billion (one third of what the U.S. invests in Ireland, for example) and Chinese investment into the United States was only $1.2 billion.

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The fact that the U.S.-EU economic relationship is so focused on investment has an important consequence — because investment is about supporting or establishing companies, it is also about creating jobs. While high trade levels raise fears of jobs leaving, high investment levels usually mean the creation of more jobs. Today, about 12 million jobs in the United States, and an equal number in Europe, are the result of transatlantic investment.

The financial crisis of 2008 demonstrated that such close economic integration can have its downside. Weaknesses in one country can be transferred swiftly to its economic partners, as demonstrated by the collapse or near collapse of several European banks that had invested in U.S. subprime mortgages. The result has been weaker economies in both the U.S. and Europe, with unemployment in both now at close to 10 percent (although in Europe, this represents a lower increase and has less of an impact, because of the more extensive social safety net). Both the U.S. and EU are now moving out of recession, but OECD forecasts call for slower growth on both sides of the Atlantic next year (2.5 percent in the U.S. and 1.15 percent in the eurozone.

An argument can certainly be made that the U.S. should strengthen its partnership with rising economic powers such as China, and not worry about the future of its economic relations with Europe. After all, the financial crisis fully demonstrated the growing importance of the BRIC countries. They have moved into the management structures of the global economy by joining the G20, as befits their growing share of the world economy. They also seem to be recovering more quickly from the financial crisis than either the United States or the EU, and expectations for next year are for a larger increase in GDP growth than either of the transatlantic partners will experience. However, there is little to suggest that U.S. exports to China will increase anytime soon. Thus, if the current U.S.-China relationship is any indication, an increase in U.S.-China trade is most likely to lead to an even greater trade deficit. The fact that European Commission President Jose Manuel Barroso recently visited Beijing to discuss a revaluation of the yuan — almost immediately after President Barack Obama's visit with the same ambition — shows whose interests are more closely aligned with those of the United States.

China, and the other emerging economies, will undoubtedly become more important partners of the United States and Europe in the future. Their economies will evolve, and trade will become less significant as investment and services become a larger part of their portfolio. But as China adapts to WTO rules and as the BRICs take on a larger role in global economic management, the U.S. and EU would be best served by working closely together. They should send consistent messages to the BRICs about the need to strengthen markets and openness in their own economies. In an era of globalization, the impact of standards and regulations goes far beyond national boundaries, and the U.S. and EU will want to work together to ensure that such rules (governing, for example, regulation of financial services, or handling of chemical substances, or accounting standards) are consistent with their preferences and economic systems. Clearly, at least some of the emerging economies have very different views of markets and adherence to contracts and rules than is the norm in the United States and Europe. This is not to say

that the U.S. and Europe always agree, but their general approaches are far more similar when compared to others. The BRICs should also be encouraged to think beyond their own interests as they carry out their evolving responsibilities as global economic leaders. The U.S. and EU can best send these messages by reinforcing and enhancing the openness in their own economies — rejecting the temptation of protectionism — and by assuming a strong role in leading the global economic recovery.

To do this, and to speed their recovery from the financial crisis itself, the U.S. and Europe must reinvigorate and strengthen the transatlantic economy. This will require a two pronged approach:

- ***Reducing the barriers that still exist between the United States and the EU to create a "Barrier Free Transatlantic Market."*** By removing as many of the obstacles as possible that inhibit even greater transatlantic investment and trade, the United States and EU can spur growth within the private sector while reinforcing the creation of highly paid, high-skilled jobs. By addressing together future areas requiring regulation and standards, the U.S. and EU can boost corporate efficiencies by providing one set of rules, while moving toward ensuring that global regulations reflect their policy preferences. In no way is such a transatlantic deepening intended to be a "Fortress Atlantique," however. Others can — and should — be integrated into these efforts as they are willing to take on the obligations and responsibilities.

- ***Leading an effort to create green economies, with an emphasis on innovation that will create jobs and prosperity.*** The financial crisis offers not only hardship, but also an opportunity. By erupting just as the U.S. and EU were looking for ways to cooperate in reducing the environmental impact of our high energy consumption, including carbon emissions, the crisis can give impetus to efforts to build a new type of economy. Based on significantly less energy consumption and on creating less pollution, this economy will require innovation and new investments in technology and infrastructure if it is to become a reality. These in turn should create new jobs and a revitalized prosperity for the transatlantic partners. It will also allow developing countries to grow economically without automatically following the patterns of high-energy consumption that have plagued the current industrialized economies, and thus benefit all of us who require a more sustainable environment.

Today is an auspicious time to begin an effort to take the transatlantic economic relationship to the next level. For the last two years, we have been in a form of political limbo, with the defeat of the Lisbon treaty in Ireland, the U.S. presidential campaign and then a rather lengthy transition, and then a European Parliament election, the passage of Lisbon, and selection of a new European Commission. This phase is now drawing to a close. The Lisbon Treaty, which took effect on December 1, moves some key economic powers to the Union institutions from the member states. The European Parliament will

now have decision-making powers in trade and agriculture, as well as in more areas related to energy and investment. Indeed, investment, which has been primarily a matter for the individual member states, will move to some extent to the Union level, making it easier for the U.S. to identify its partner in discussing that issue. In addition, Lisbon gives the Union its own legal personality, making it easier to conclude agreements that do not have to be approved by all 27 member states. By February, we hope that the new European Commission will be in place and it will be time to get down to business. In another important innovation, the European Parliament will open a small office in Washington with the aim of increasing cooperation with the Congress; such cooperation could be especially fruitful in the projects identified below.

Building a Barrier Free Transatlantic Market [2]

Removing the remaining barriers to a truly open U.S.-EU market will require a multi-stage effort to reduce remaining tariff barriers, overcome regulatory obstacles, remove investment restrictions, and align future standards. It will be controversial and difficult; the remaining barriers persist precisely because they have been the most difficult to remove. Transatlantic trade disputes in recent years have increasingly been about regulatory obstacles, such as the unwillingness of many European countries to import genetically modified foods, and these issues have become extremely sensitive. Moreover, responsibility for areas such as regulation and investment are often split between the EU and member states in Europe and between federal and state (or even local) governments in the U.S., so just figuring out who should be involved in discussions can be a real challenge.

In recent years, the effort to reduce barriers in the global economy has focused on the Doha Development Round. There will be those who argue that a transatlantic initiative will undercut the Doha Round, and privilege the United States and Europe. In reality, the DDR has been stalled because of disagreements between the industrialized economies and those emerging economies that are reluctant to improve access to their own markets. Any transatlantic initiative should be open to others once it is established, and it may actually provide some important leverage to move the Doha Round forward. For both the United States and the EU, the goal should be to pursue the transatlantic and the multilateral efforts to a successful conclusion. But the Doha Round, even if successfully concluded, will not address the most central issues in the U.S.-EU economic relationship. Mutual recognition or harmonization of regulations, tax differences, competition policies, divergent standards for products — these are all central to the U.S.-EU market but are not included in Doha. Their importance reflects how integrated that market is already, in that

[2] This section and the following one draw on the recently released report *Shoulder to Shoulder: Forging a Strategic U.S.-EU Partnership,* by Daniel S. Hamilton and Frances G. Burwell. Issued by the Center for Transatlantic Relations at SAIS and the Atlantic Council of the U.S. in December 2009, the report represents a collaborative project among five European think tanks, CTR, the Atlantic Council, and CSIS. It is available at the websites of most of these institutions, including www.acus.org.

it is not external barriers, such as tariffs, but domestic policy choices, such as consumer product safety standards, that have a significant impact.

To move toward a Barrier Free Transatlantic Market, the U.S. and EU should:

- ***Announce a joint commitment to work towards a "tariff only" Free Trade Agreement, eliminating all duties on traded industrial and agricultural products, as an important intermediate goal.*** Given that most transatlantic tariffs are low and often simply have nuisance value, a focused tariff-only free trade agreement could be achieved relatively quickly. It is likely to enjoy a broader base of domestic political support. The U.S. AFL-CIO has long championed a transatlantic free trade agreement, for example, and would likely accept a goods-only version. It is likely to have immediately beneficial effects on investment, profits and jobs, since two-thirds of U.S.-EU trade is intra-firm, i.e. companies trading intermediate parts and components among their subsidiaries on both sides of the Atlantic. Tariffs on agriculture have always been the major problem, but with agricultural trade growing across the Atlantic, now may be the time to take a bold step forward. Where agricultural tariffs are high, phase-out periods could be longer. Moreover, European and American agricultural sectors would still remain implicitly protected by a range of non-tariff barriers that are far more important, lessening the political concerns that might accompany a complete liberalization.

- ***Once such a deal is negotiated, the U.S. and EU should invite others to join in certain sectors or in the overall arrangement.*** If a critical mass of participants develops, benefits should be extended to all WTO members on an MFN basis. This approach was successful in negotiations leading to the 1997 International Telecommunications Agreement. This may create incentives for many other countries who would like full access to the transatlantic market to lobby major developing countries such as India and China to join, as other countries are only likely to benefit after those major economies agree.

- ***Initiate transatlantic negotiations aimed at reducing barriers globally in certain sectors, starting with services.*** Such negotiations may trigger plurilateral negotiations to include other partners. An initial transatlantic initiative can be a building block for more global arrangements. On both sides of the Atlantic, services now make up more than half of GDP, and the output of the protected services sectors is larger than that of protected agricultural and manufacturing sectors. A targeted opening of services could present vast opportunities to firms and huge gains to consumers. The main market for the growth in U.S. service-sector exports has been Europe, not the Asia-Pacific region. U.S. service-sector exports to the EU have tripled since 1995, reaching $198 billion in 2008 – $62 billion more than the U.S. earned from exporting services to countries in the Asia-Pacific region. EU service-sector exports to the U.S. have also tripled – from $46 billion in 1995 to $152 billion in 2008.

- ***Remove remaining barriers to mutual investment, while developing reasonable and compatible guidelines for national security reviews.*** Ownership restrictions on

marine shipping, airlines, and infrastructure should be removed in most cases. In those situations where national security considerations might apply, there should be an appropriate review process. CFIUS, in the United States, has no EU equivalent, although several member states do have similar processes. Although implementation is likely to remain with the national authorities, the U.S. and EU, together with the member states, should develop guidelines for allowing foreign investment to flourish with reasonable national security safeguards. In time, such guidelines might become a global standard as other countries grapple with the balance between prosperity and security.

- ***Creating an open transatlantic market for air transport by allowing cabotage and removing restrictions on foreign investment.*** At the 2009 U.S.-EU Summit both sides confirmed their intention to reach an air transport agreement that would essentially achieve this goal. Both sides should commit to completing this agreement in 2010. There are estimates that a full open skies agreement could boost transatlantic travel by up to 24 percent, save consumers more than $6 billion annually and increase economic output in related industries by at least $9 billion a year. The impact of this one single sectoral agreement could have the equivalent economic boost on the U.S. and EU economies as the entire Doha Round.

- ***Boost bilateral regulatory cooperation by identifying "essentially equivalent" regulations for mutual recognition, focusing on regulatory cooperation relevant to new technologies, and ensuring that regulatory agencies have the resources and incentives to cooperate internationally.*** Since "behind the border" regulatory differences pose the most significant barriers to transatlantic commerce, the transatlantic partners should seek to address these differences with far greater urgency and attention. As indicated, there is considerable potential to create jobs, stimulate investment, and boost trade. U.S. and EU regulators generally have the same high standards for protecting the welfare of our consumers, our environment and our financial systems. This commonality of regulatory purpose implies that we *can* trust one another's regulatory systems; In October 2009 the U.S. and EU agreed to take "steps that could lead toward greater compatibility of effective and economically beneficial regulation and that could promote economic integration." The U.S. and EU have identified key sectors, including labeling, energy efficiency, and nanotechnology, where both sides will seek to develop compatible approaches to regulation. To go farther, the High Level Regulatory Cooperation Forum should be tasked to provide specific recommendations to the spring 2010 meeting of the Transatlantic Economic Council aimed at achieving mutual recognition of compatible regulatory regimes in individual regulated sectors (toys, engines, automobiles, electrical products, etc.). If agreement can be reached that both sides are seeking "essentially equivalent" outcomes in terms of health, safety, etc. in such areas, then the legislative process on both sides should accept the regulatory decisions and standards of the other side. The process for reaching this decision should be in the hands of U.S. and EU regulators, who would always have the right to withdraw the automatic approval for products approved by the other. In addition, regulators and legislators on both sides of the Atlantic should focus on emerging areas of technology

that will require regulation but where persistent disputes do not yet exist. Areas such as nanotechnology, e-health records, RFID, and "green" technologies may be easier to regulate cooperatively before differences emerge. Furthermore, financial resources must be available that allow regulators to engage in sustained, face-to-face dialogue with international partners. Such resources should not compete with the regulating agencies' core mandates for budget and staff resources.

Building a Green Economy for Innovation, Jobs, and Prosperity

A transatlantic "green economy" offers an opportunity to encourage innovation and revitalization of key economic sectors, while fostering greater energy and environmental sustainability. By using the opportunity of the financial crisis to motivate governments, firms, and individuals to change their established patterns of consumption and behavior, we can not only promote economic recovery, but also reduce carbon emissions.

Both the United States and Europe bring real value to such an endeavor. The U.S. was long the leader in innovative, market driven environmental solutions, including the cap-and-trade system for sulphur dioxide. The U.S. has an outstanding track record in turning innovation into profitable ventures, given the right economic incentives. In recent years, Europe has become the world leader in promoting energy efficiency standards in buildings, and has pledged to make renewables twenty percent of its energy mix by 2020. At the November 2009 U.S.-EU summit, the parties demonstrated their commitment to energy sustainability and security by establishing a new Energy Council to pursue such efforts in a cooperative and coordinated framework.

To begin building such a green economy, the U.S. and EU should:[3]

- ***Boost energy innovation by creating a U.S.-EU Clean Energy Bank and a Transatlantic Energy Innovation Fund.*** The Clean Energy Bank, which would be open to others, would underwrite the risks of developing new, commercially viable technologies. It would help commercialize new technologies, some of which might be developed under the Innovation Fund. That fund would support joint research and development to accelerate the introduction on new technologies for electric mobility (car technology, batteries, infrastructure); super smart grid; renewable energy development and deployment; carbon capture and storage; and energy efficiency.

- ***Encourage enhanced energy efficiency, including the joint development of smart grid and carbon capture and storage technologies.*** The U.S. and EU must harmonize emerging regulatory frameworks on these two technologies to ensure that standards reinforce interoperability and compatibility. They should work together to develop

[3] In addition to *Shoulder to Shoulder*, this section also draws on "A Shared Vision for Energy and Climate Change: Establishing a Common Transatlantic Agenda," by John Lyman, in *Shoulder to Shoulder*, the companion edited volume to this report, and on "Transatlantic Cooperation for Sustainable Energy Security: A Report of the Global Dialogue between the European Union and the United States," by Franklin Kramer and John Lyman (Washington DC: CSIS, 2009).

the capacity to protect smart grids from cyber attacks and initiate a number of joint carbon capture and sequestration projects. They should collaborate on establishing energy efficiency standards, including setting higher standards for appliances, making standards associated with building products more consistent, and agree that only products with the highest efficiency ratings be eligible for public procurement.

- ***Head off the looming collision between climate policy and trade***. Failure to coordinate these two key components of the broader system could both imperil the climate change talks and stimulate major new trade conflicts. It is untenable politically to enact cap-and-trade systems that impose costs on companies operating in the U.S. or Europe only to have them shift jobs and pollution to countries such as China or India, which are reluctant to embrace binding emission reductions. Yet potential remedies, such as imposing additional "border charges" on carbon-intensive imports and subsidizing domestic producers, could lead to retaliation or WTO challenges that might undermine climate and trade agreements. The U.S. and EU should demonstrate leadership by working with G20 partners to develop a “Green Code” of multilateral trade disciplines and consider new trade negotiations to address these potential commercial and climate trade-offs.

- ***Implement the commitment at the October 2009 TEC meeting to establish a new U.S.-EU innovation dialogue*** to accelerate efforts to spur growth, productivity and entrepreneurial activity, including by sharing best policy practices and ways of improving the policy environment for innovative activities in both markets. The Dialogue will establish with stakeholders a work program identifying priority areas and sectors for action, including innovation policy, information and communication technologies, advanced technologies, health information technology, and clean energy technologies.

- ***Ensure that the new U.S.-EU Energy Council develops a focused agenda and effective working groups.*** At the 2009 U.S.-EU Summit, a ministerial-level U.S.-EU Energy Council was established to deepen the dialogue on strategic energy issues; improve energy security; promote cooperation in achieving climate change goals; and further strengthen research collaboration on sustainable and clean energy technologies. This is a broad agenda, and much will depend on the working groups addressing some key issues where progress can be made (such as smart grids, carbon capture and storage, etc.). The Energy Council does have a regulatory role, and this should work cooperatively with the Transatlantic Economic Council rather than becoming competitive. The Energy Council must also provide for active involvement of U.S. and European legislators and the business community.

Reinvigorate the Transatlantic Economic Council[4]

To achieve these aims of building a barrier free transatlantic market and a transatlantic green economy, the U.S. and EU must reinvigorate the Transatlantic Economic Council as the premier forum for discussions about the transatlantic economic relationship. Created as a result of a German initiative in 2007, the TEC brings together the principal Cabinet officers, White House officials, and European Commissioners for a meeting twice per year. In its initial conception, the TEC was to provide political impetus to solve regulatory issues that could not be resolved by the High-Level Regulatory Cooperation Forum and other bodies. Over the past two years, however, the TEC became overly focused on pre-existing trade disputes, to the point that its last meeting during the Bush administration was dominated by the U.S.-EU dispute over chlorine-washed chickens. The first TEC under the Obama administration was used primarily to set a general agenda for the next few years, including pledging to initiate an innovation dialogue. But many of those attending from the European side were effectively "lame ducks" as the new European Commission had not yet been announced, with the exception of Commission President Barroso. In spring 2010, the TEC meeting will include new European Commissioners. Commissioner Karel de Gucht, who has held the development portfolio, will have the trade and investment portfolio, which now includes the TEC. With the U.S. and EU having finished their government transitions, the spring 2010 meeting presents a golden opportunity to revamp the TEC by making both substantive and institutional changes.

In terms of agenda, the TEC should focus on strategic issues in three areas:

- ***Promoting economic recovery and growth, with a focus on building a green economy and boosting innovation.*** The TEC should ensure that government interventions are well coordinated, mutually supportive, and of limited duration. The TEC should help coordinate "exit strategies" if necessary, and be a watchdog on protectionist impulses.

- ***Coordinating approaches to global economic governance, effectively becoming an informal G2*** for U.S.-EU discussions prior to the G20 meetings. With the weakening of the G8, there are few fora left where the U.S. and EU can develop a strategic approach to the new, larger institution and the issues of global economic management.

- ***Advancing efforts to create a barrier-free transatlantic market, including through pursuit of several regulatory "lighthouse" projects.*** These could include financial services regulation, e-health regulation, intellectual property rights, and many others. Of particular interest might be those emerging industries and technologies where little regulation yet exists.

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[4] This section draws on *Shoulder to Shoulder: Forging a Strategic U.S.-EU Partnership* and also on *Resetting the Transatlantic Economic Council*, a report of the Atlantic Council of the U.S. and the Bertelsmann Foundation (Washington DC, 2009, available at www.acus.org).

To address these issues effectively, the TEC must:

- ***Maintain a strategic focus.*** This might be best accomplished by establishing a two-level TEC; the ministerial-level Council that will usually address issues on a strategic level, and a series of sub-Councils at the next level down to deal with specific issues.

- ***Expand the circle of those engaged, especially by bringing in key legislators and the Transatlantic Legislators' Dialogue.*** The very dense nature of transatlantic economic relations means that many constituencies are affected. None of the obstacles that need to be overcome — tariffs, regulatory, investment barriers — can be addressed without the cooperation of the business community or legislators. In the past, both the Congress and the European Parliament have passed measures that created barriers to transatlantic economic interaction; Sarbanes-Oxley is a prominent but not isolated example. Given the new range of powers the Parliament will receive under Lisbon, it is even more important than ever that both the Congress and European Parliament be an integral part of the TEC. Legislators could develop a regular mechanism for identifying pending legislation that might have an extraterritorial impact and that should be examined more closely. By providing such a report regularly to the TEC and engaging key Committee chairs in regulatory issues of their jurisdiction, legislators could become an essential part of the TEC dialogue.