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EU-U.S. Economic Ties: Framework, Scope, and Magnitude

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EU-U.S. Economic Ties: Framework, Scope, and Magnitude

Summary

The United States and the European Union (EU) economic relationship is the largest in the world — and it is growing. The modern U.S.-European economic relationship has evolved since World War II, broadening as the six-member European Community expanded into the present 25-member European Union. The ties have also become more complex and interdependent, covering a growing number and type of trade and financial activities.

In 2004, $966 billion flowed between the United States and the EU on the current account, the most comprehensive measure of U.S. trade flows. The EU as a unit is the largest **merchandise** trading partner of the United States. In 2004, the EU accounted for $172.6 billion of total U.S. exports (or 21.1%) and for $282.6 billion of total U.S. imports (or 19.2%) for a U.S. trade deficit of $110.0 billion. The EU is also the largest U.S. trade partner when trade in **services** is added to trade in merchandise, accounting for $115.6 billion (or 34.0% of the total in U.S. services exports) and $108.7 billion (or 37.3% of total U.S. services imports). In addition, in 2004, a net $83.8 billion *flowed* from U.S. residents to EU countries into direct investments, while a net $48.2 billion *flowed* from EU residents to direct investments in the United States.

Policy disputes arise between the United States and the EU generating tensions which sometimes lead to bilateral trade disputes. Yet, in spite of these disputes, the U.S.-EU economic relationship remains dynamic. It is a relationship that is likely to grow in importance as the trends toward globalization and the enlargement of the EU continue, forcing more trade and investment barriers to fall. The expanded relationship will bring economic benefits to both sides in the form of wider choices of goods and services and greater investment opportunities.

But increasing economic interdependence brings challenges as well as benefits. As the U.S. and EU economies continue to integrate, some sectors or firms will "lose out" to increased competition and will resist the forces of change. Greater economic integration also challenges long-held notions of "sovereignty," as national or regional policies have extraterritorial impact. Similarly, accepted understanding of "competition," "markets," and other economic concepts are tested as national borders dissolve with closer integration of economies.

U.S. and EU policymakers, therefore, will continually face the task of how to manage the increasingly complex bilateral economic relationship in ways that maximize benefits and keep frictions to a minimum. For Members of Congress it means weighing the benefits of greater economic integration against the costs to constituents in the context of overall U.S. national interests. This report will be updated as events warrant.

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The bilateral economic relationship between the United States and the European Union (EU) is the largest such relationship in the world — and it is growing.[1] It is a relationship forged over several centuries, since the European colonization of North America.

The modern U.S.-European economic relationship has evolved since World War II. It has broadened as the six-member European Community expanded into the present 25-member European Union. The ties have also become more complex, covering a growing number and type of trade and financial activities that intertwine the economies on both sides of the Atlantic into an increasingly interdependent relationship. For Members of Congress and other policymakers, the EU remains a significant participant in the U.S. economy and a major factor in policy considerations. For example, the EU and its members are influential members of the World Trade Organization (WTO), the Organization for Economic Cooperation and Development (OECD), the International Monetary Fund (IMF) and the World Bank, and, together with the United States, play decisive roles in developing and implementing the missions of those institutions.

Despite the tightness of the bilateral relationship, policy tensions arise generating tensions within the relationship, sometimes leading to bilateral trade disputes. The issues that arise are becoming more complex, reflecting the growing integration of the U.S. and EU economies. Yet, in spite of these disputes, the U.S.-EU economic relationship remains dynamic and one within which trillions of dollars of economic activity transpire.

This report provides background information and analysis of the U.S.-EU economic relationship. It examines the economic and political framework of the relationship and the scope and magnitude of the ties based on data from various sources. In addition, the report analyzes the implications these factors have for U.S. economic policy toward the EU. The report will be revised as events warrant.

U.S. Interests

The United States has been a strong advocate for the construction of close economic ties among the West European countries since the end of World War II.

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[1] The EU consists of Austria, Belgium, Cyprus (Greek), Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Slovakia, Slovenia, Spain, Sweden, and the United Kingdom.

During the Cold War, the European Community served U.S. foreign policy and national security interests as a force of stability that drew former enemies — (West) Germany and France — closer together and that helped to build Western Europe into an economic bulwark against the Soviet Bloc.

The formation of an economically unified Europe has served U.S. economic interests as well by accelerating European economic growth and development which has opened trade and investment opportunities for the United States. Many studies have concluded that the formation of the EU has had a net positive economic impact on the world as a whole because it has led on balance to more trade *creation* than *diversion* of trade from other countries.[2]

The EU continues to become a more closely knit entity with the formation of the European Monetary Union comprising 12 of the 25 members of the EU and their adoption of a common currency, the euro. These developments have already had an impact on U.S.-EU trade ties.

The Framework of U.S.-EU Economic Ties

U.S.-EU economic relations exist within a framework of economic, political and security factors. Some of these factors have promoted closer economic relationships, while others have created tensions that have, at times, threatened to undermine the relationship.

The U.S.-EU economic relationship dominates the world economy by the sheer size of their combined economies. The combined population of United States and the EU members exceeds 650 million people who generate a combined gross domestic product (GDP) that is roughly equivalent to 57% of world GDP.[3] Combined EU and U.S. world trade accounts for over half of all world trade. In other words, the U.S.-EU economic relationship has clout.

The United States and the EU member countries are of roughly equivalent levels of economic development and are among the most advanced in the world. As a group they include the world's wealthiest and most educated populations. The United States and the members of the EU, with a few exceptions, are major producers of advanced technologies and services. As a result U.S.-EU trade tends to be intra-industry trade; that is trade in similar products, such as cars and computers, dominate two-way trade flows. Furthermore, the United States and the EU have advanced and integrated financial sectors which facilitate large volumes of capital flows across the Atlantic. These capital flows account for a significant portion of the bilateral economic activity.

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[2] Studies on the economic effects of the EU cited in CRS Report 97-663, *Regional Trade Agreements: Implications for U.S. Trade Policy*, by George Holliday.

[3] Based on data found in Standard and Poor's DRI. *The World Outlook: An Analytical Guide to International Business.* First Quarter 2000. p. B14.

The dominance of security and defense matters is another factor influencing U.S.-EU ties. Nineteen of the EU-25 are members of NATO, and represent a majority of NATO's 26 members. NATO members must deal with a number of issues that pertain to foreign trade, such as defense-related government procurement, product standardization, controls of exports of dual-use technologies and related products, and economic sanctions. National security and foreign policy concerns strongly dominated the U.S.-European relationship during the Cold War.[4]

The WTO (and its predecessor, the General Agreement on Tariffs and Trade (GATT)) is a critical part of the EU-U.S. bilateral economic framework. The WTO provides the principles and rules under which the U.S. and the EU conduct much of their trade. The basic principles of most-favored-nation(MFN), or nondiscriminatory, treatment and of national treatment of imports of goods and services and of foreign investments, along with WTO rules on trade-related intellectual property rights, investment, and trade remedy practices (antidumping and countervailing duties and safeguards) are the foundation of U.S. and European trade and investment policies. The WTO also provides the mechanism by which the United States and the EU resolve many of their bilateral trade disputes.

To a lesser extent, the OECD is an important element in the U.S.-EU framework. Largely consisting of fully industrialized countries, the 30-member OECD coordinates economic policies and reviews economic conditions and polices of its members and those of some non-members. The OECD also has some rules and guidelines for trade and investment practices of its members. For example, the OECD Arrangement on Official Export Credits curbs the subsidization of exports.

EU and U.S. policies and practices form another element of the bilateral economic framework. The United States and the EU share a commitment to open trade and investment. The United States and European countries were largely instrumental in establishing the post-World War II foundation for an open international economic system. This commitment has played a large role in the strong economic ties between them. Yet, the two sides differ in some significant policy areas, for example, the EU's Common Agricultural Policy, conflicting competition policies, and the U.S. extraterritorial application of economic sanctions against Cuba and other countries. These policy differences have been a source of sharp bitterness.

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[4] But even the dominance of national security concerns did not prevent at least some major disputes to surface between the United States and the EU. For example, in June 1982, the United States imposed controls on exports to the Soviet Union of oil and gas equipment technology that was produced by U.S.-owned firms in foreign countries. The restrictions were in response to Soviet support of martial law in Poland and to hamper the construction of a natural gas pipeline that would deliver Soviet gas to Western Europe. The measures led to an open confrontation with the European Community which argued that the United States could not apply U.S. controls outside the United States. The United States rescinded the controls in November 1982. Featherstone, Kevin and Roy H. Ginsburg. *The United States and the European Community in the 1990s: Partners in Transition.* St. Martin's Press. United Kingdom. 1993. p. 179-180.

U.S.-EU Trade in Goods and Services

The EU as a unit is the largest **merchandise** trading partner of the United States (surpassed only by Canada). In 2004, the EU accounted for $150.5 billion of total U.S. exports (or 21.1%) and for $244.8 billion of total U.S. imports (or 19.2%) for a U.S. trade deficit of $110.0 billion. At the same time, the United States is the largest non-EU trading partner of the EU as a whole. In 2003, EU exports to the United States accounted for 22.9% of total exports to non-EU countries, while EU imports from the United States accounted for 15.5% of total imports from non-EU countries.[5]

Table 1. U.S. Merchandise Trade with Selected Trade Partners, 2004

(billions of dollars)

Partner	U.S. Exports	U.S. Imports	U.S. Trade Turnover	U.S. Trade Balances
EU-25	172.6	282.6	455.2	-110.0
Canada	190.2	255.9	446.1	-65.8
Mexico	110.8	155.8	266.6	-45.1
China	34.7	196.7	231.4	-162.0
Japan	54.4	129.6	184.0	-75.2
World	819.0	1,470.5	2,299.5	-651.5

Source: U.S. Department of Commerce. Bureau of the Census.

For a number of years, the United States realized trade surpluses with the EU. However, since 1993, the United States has been incurring growing trade deficits with the EU ($110.0 billion in 2004). The sharp increase in U.S. imports from the EU in comparison with U.S. exports to the EU suggests that the robust economic growth the United States has been experiencing is a significant factor in the growth of the U.S. trade deficit.

Among the top U.S. exports to the EU have been aircraft, and machinery of various kinds, including computers, integrated circuits, and office machine parts. A large share of U.S. imports from the EU has consisted of passenger cars, machinery of various types, including gas turbines, computers and components, office machinery, and parts and organic chemicals. Within the EU, Germany, the United Kingdom, and France are the leading U.S. trading partners, followed by the Netherlands and Italy.

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[5] Calculations for U.S. trade based on data from the U.S. Department of Commerce. Bureau of the Census. EU trade data found on EU website:[http://www.europa.eu.int].

The EU is the largest U.S. trade partner when trade in **services** is added to trade in merchandise. In 2004 the EU accounted for $115.6 billion (or 34.0% of the total in U.S. services exports). Of this amount, $23.1. billion derived from receipts for various travel services, $6.5 billion from payments for passenger fares, and $11.1 billion for other transportation fees (freight and port services). Another $21.3 billion were in receipts for royalties and licensing fees and $51.0 billion derived from other private sector services, including business, professional and technical services (including legal services), and insurance. Also included under services are revenues from transfers under U.S. military contracts which equaled $2.6 billion in 2004.

In 2004, the EU accounted for $108.7 billion (or 37.3% of total U.S. services imports) — including travel services ($20.0 billion), passenger fees ($10.8 billion), and freight and port fees ($17.2 billion). Royalties and licensing fees accounted for another $9.4 billion. In addition, other private sector services accounted for $33.9 billion of imports. Also included were payments of $10.4 billion in defense-related expenditures.[6]

[6] U.S. Department of Commerce. Bureau of Economic Analysis. *U.S. International Transactions Accounts Data.* March 16, 2005. [http://www.bea.doc.gov]

Table 2. U.S. Trade with the European Union in Goods and Services, 1996-2004

(billions of dollars)

U.S. Exports

	1996	1997	1998	1999	2000	2001	2002	2003	2004
Goods & Services	218.0	240.5	232.4	236.4	257.5	244.5	238.4	250.7	283.2
Goods*	137.2	153.0	145.9	148.9	162.3	155.8	140.4	147.6	167.6
Services	80.8	87.5	86.5	87.6	95.2	88.7	98.0	103.2	115.6

U.S. Imports

	1996	1997	1998	1999	2000	2001	2002	2003	2004
Goods & Services	223.4	243.5	242.3	264.4	298.6	293.2	311.3	338.6	387.6
Goods*	161.6	175.8	176.1	194.5	219.9	219.5	225.4	244.9	278.9
Services	61.8	67.7	66.2	69.9	78.7	73.7	85.2	93.7	108.7

U.S. Trade Balances

	1996	1997	1998	1999	2000	2001	2002	2003	2004
Goods & Services	-5.4	-3.0	-9.9	-28.0	-41.1	-48.7	-72.9	-87.8	-104.4
Goods*	-24.4	-22.8	-30.2	-45.6	-57.6	-63.7	-85.0	-97.3	-111.3
Services	19.0	19.8	20.3	17.7	16.5	15.0	9.7	9.5	6.9

Source: U.S. Department of Commerce. Bureau of Economic Analysis. *Survey of Current Business*. Various issues.

*The figures for goods trade while essentially equivalent to those for merchandise trade in **Table 2**, are slightly lower as they are measured on a balance of payments basis, rather than a census basis.

Table 2 indicates that the United States has consistently run surpluses in services trade with the EU. Recently, these surpluses have been rather large and have helped to offset the U.S. merchandise trade deficits.

A substantial amount of funds flows between the United States and the EU as receipts of income derived from assets, including direct and portfolio investments and government securities. In 2004, $141.4 billion flowed to the United States from income earned on EU assets held by U.S. residents. In 2004, $152.8 billion flowed to the EU as income earned on assets held in the United States by EU residents. In addition, a net $0.4 billion flowed into the United States from the EU as unilateral transfers. Trade in goods and services, plus income receipts and payments, plus unilateral transfers, make up the U.S. **current account**, the most comprehensive measure of U.S. trade flows. In 2004, the United States incurred a **current account deficit** with the EU of $115.4 billion.[7]

Table 3. U.S. Current Account Balance with EU, 2004
(billions of dollars)

Exports Goods and Services	283.2
Imports Goods and Services	387.6
Income Receipts	141.7
Income Payments	153.2
Unilateral Transfers (Net)	0.4
Total Current Account Flows	**965.7**
Current Account Balance	**-115.4**

Source: U.S. Department of Commerce. Bureau of Economic Analysis. *U.S. International Transactions Accounts Data.* March 16, 2005. [http://www.bea.doc.gov]

In sum, the flows of merchandise or goods trade, services trade, and income between the United States and the EU manifest a very active, strong, and large

[7] U.S. Department of Commerce. Bureau of Economic Analysis. *U.S. International Transactions Accounts Data.* March 16, 2005. [http://www.bea.doc.gov]

economic relationship. In 2004 alone, a total of $965.7 billion flowed between the EU.[8]

U.S.-EU Investment Flows and Positions

Transactions on the current account represented only a part of the volume of international financial *flows* between the United States and EU in 2003. The remaining transactions are on the *capital account* which derive from payments by the U.S. government and residents to obtain assets in the EU and by EU residents to obtain assets in the United States.[9] These assets include government purchases of gold and foreign currencies for their official reserves and government purchases of other foreign assets. The capital account also includes payments by U.S. residents for portfolio investments (including bank deposits, government securities, corporate stocks, and bonds, and other private sector securities) and payments to obtain direct investments (including real estate, plants, factories, and commercial establishments). In 2004, the net flow of U.S. capital to EU members was $394.5 billion and the net flow of capital from EU countries into the United States was $463.9 billion.[10]

Foreign direct investments (FDI) represent long-term commitments on the part of the investor. In 2004, a net $83.3 billion *flowed* from U.S. residents to EU countries into direct investments, while a net $48.2 billion *flowed* from EU residents to direct investments in the United States.[11] By the end of 2003 (latest data available), the *position* of U.S. direct investment in EU countries stood at $844.7 billion, or 47.2% of all foreign direct investment by U.S. residents.[12] Of that total, $160.3 billion, or 19.0%, was in the manufacturing sector. Another 15.3% was in banking and other financial establishments, and insurance firms. The United Kingdom-accounting for 32.3%- is by the far the largest destination of U.S. FDI in the EU followed by the Netherlands at 20.8%, Germany at 9.5%, and France at 5.7%. At the end of 2003, EU residents had foreign direct investments in the United States valued at $855.7 billion. The United Kingdom was the largest source of those investments with 26.9% of the total in 2003.[13]

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[8] Ibid.

[9] The Department of Commerce only reports net, rather than total, capital inflows and outflows. The capital account is also the mirror image of the current account in U.S. balance of payments accounts.

[10] U.S. Department of Commerce. Bureau of Economic Analysis. *U.S. International Transactions Accounts Data.* March 15, 2005. [http://www.bea.doc.gov]

[11] Ibid.

[12] The foreign investment *position* represents the value of total accumulated investments in place and is valued on an historical-cost basis, that is, the value at the time of purchase. Foreign investment *flows* represent the net value of investment transaction during a particular year.

[13] *Survey of Current Business.* September 2004.

Conclusions and Policy Implications

Foreign trade and investment data depict a strong, interdependent, and significant U.S.-EU bilateral economic relationship. It is a relationship that is likely to grow in importance as advancements in technology and other forces of globalization, plus the future enlargement of the EU, force more trade and investment barriers to fall. The expanded relationship will bring economic benefits to both sides in the form of wider choices of goods and services and greater investment opportunities.

But increasing economic interdependence brings challenges as well as benefits. U.S.-EU trade ties have been plagued by disputes that at times have reached the highest levels of policymaking. While these disputes have covered a range of sectors and issues, the most contentious and public have been related to trade in agricultural and agricultural-related products. Recently, for example, the United States has taken the EU to task for its ban on hormone-enhanced beef imports and for its policy regarding banana imports.

Yet, the agriculture sector accounts for a very small portion of not only U.S.-EU bilateral trade but also for the total world trade of the two entities. Agriculture accounts for around 5% of total U.S. exports and imports with the EU. Similarly, agriculture accounted for only about 7% of total U.S. world exports and for about 8% of total EU world exports.[14] It is beyond the scope of this report to analyze this contrast between U.S. and EU trade policies and trade volume. But the contrast suggests that the attention received by these disputes at the official level, as well as from the press, reflects the domestic political salience of these issues to a much further extent than their overall commercial or economic significance.

Greater economic integration also challenges long-held notions of "sovereignty," as national or regional policies have extraterritorial impact. For example, the U.S. use of foreign policy trade sanctions against such "rogue states" as Cuba and Iran affected EU firms and investors and caused sharp U.S.-EU friction. Similarly, accepted understandings of "competition," "markets," and other economic concepts are tested as national borders dissolve with closer integration of economies.

U.S. and EU policymakers, therefore, continually face the task of how to manage the increasingly complex bilateral economic relationship in ways that maximize benefits and keep frictions to a minimum. For Members of Congress it means weighing the benefits and costs to constituents of greater economic integration and placing this calculation in the context of overall U.S. national interests.

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[14] Calculations made on data obtained from the U.S. Department of Agriculture's Foreign Agricultural Service.