U.S.-European Love Affair

Forget the headlines. The money ties binding the world's two largest economies are quietly strengthening.

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THE INTERNATIONAL ECONOMY
THE MAGAZINE OF INTERNATIONAL ECONOMIC POLICY
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A great deal has been made of the festering alienation between the United States and Europe, the two largest economic blocs in the world and ones that have been intertwined for centuries. Polls of the European public invariably show hostility to U.S. government policy and abysmal approval ratings for President George W. Bush. In the United States, it's easy to detect hostility toward European countries that have been critical of American foreign policy—toward France, most notably, but also toward Germany and Spain. (Just watch a few minutes of comedian-turned-neocon pundit Dennis Miller's CNBC talk show, if you can bear it.) A series of trade disputes—the ongoing feud over agricultural subsidies and the inability of the U.S. Congress to resolve illegal export tax breaks—has further poisoned the atmosphere. "On major strategic and international questions today," Robert Kagan wrote in an influential July 2002 *Policy Review* article, "Americans are from Mars and Europeans are from Venus: They agree on little and understand one another less and less."

Acts of economic isolation may garner large headlines—the New Jersey restaurateur who poured out his French wine, the ongoing Euro campaigns against McDonald's. But executives, investors, consumers, and tourists are seeing through their rhetoric. Looking across a broad landscape of economic data, it's clear that Kagan is wrong—at least when it comes to commerce. In the past couple of years, the Atlantic World has become more closely knit together, not rent further apart. Economic integration between the United States and Europe is deepening and growing stronger—despite significant disagreements over foreign, monetary, and fiscal policy. The Concorde may no longer fly, but people, goods, services, and cash—dollars, euros and British pounds sterling—are still speeding across the

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The U.S.-European trade is where the money is.

chilly maritime divide that separates the Old World from the New World.

Let's go to the numbers. The broadest measure of economic integration—the absolute level of imports and exports—has grown. Both U.S. imports from the Eurozone and U.S. exports to the Eurozone are up—thanks to the insatiable American consumer and the strength of the euro. In 2003, according to the International Trade Administration, U.S. exports to Europe were $172 billion, up 5.1 percent from 2002—although still below the boom years of 2000 and 2001. Nearly a quarter of all U.S. exports go to Europe. The United States last year exported more goods and services to Europe than to its North American Free Trade Agreement counterparts Canada ($169.77 billion) and Mexico ($97.5 billion).

U.S. total imports rose 8.5 percent in 2003 to $1.26 trillion. But imports from Europe grew at a faster pace—up 9.1 percent to $284.55 billion. Again, the United States imported more from Europe than it did from its individual NAFTA counterparts, and from Japan and China *combined.* Imports from France rose 3.5 percent to over $29 billion, and imports from Germany soared 8.9 percent to $68 billion—despite the fact that the dollar weakened against the euro in 2003. And these trends are continuing. For the first four months of 2004, U.S. exports to Europe are up 11.6 percent, while imports from Europe are up 12.7 percent.

People are moving, too. The global tourism industry suffered a meltdown in 2001 and 2002 due to the rare synchronous recessions in the United States, Europe, and Japan, and the September 11 attacks. But despite the greater hassles associated with travel, cross-Atlantic tourism is rising sharply again. According to the Travel Industry Association, U.S. arrivals from Europe grew by 1 percent in 2003 to 8.7 million. Not too impressive. But in the first four months of 2004, the figures have grown sharply—up 18.7 percent from 2003. Arrivals from France rose 12.7 percent; German arrivals rose 20.5 percent. Plainly, Old European tourists feel welcome in the United States.

In 2002, the number of Americans traveling to Europe fell 12 percent to 10.677 million. And there were scattered signs of travel groups boycotting France in 2002 and 2003. But the allure of April in Paris and Provence in July seems to have overcome the ill will generated by Dominique de Villepin and Gerhard Schröder. In 2003, despite rising public antipathy and sharply reduced purchasing power, the number of Americans traveling to Europe rose 3 percent. And in the first two months of 2004, according to the International Trade Administration, the number of U.S. travelers to Europe was up 8 percent. This year could see the greatest number of Americans backpacking, biking, and eating their way through the Continent since the halcyon days of 2000.

Many of these transatlantic travelers are businessmen and women looking for deals. Virtually every day brings news of a cross-Atlantic deal. While none have been blockbusters, à la Daimler-Chrysler, the flow has been remarkably steady. Yahoo! in March bought French comparison-shopping service Kelkoo for $576 million. Goodyear Tire in June increased its investment in a Slovenian tire venture. French bank BNP is buying U.S.-based Community First Bankshares for $1.2 billion. Danaher Corp. agreed to pay $424 million for Kaltenbach & Voight, a German company that makes dental equipment. In June, First Data Corp. agreed to acquire the outsourcing operations of Greek information-technology company Delta Singular SA for $248 million, Viacom struck a deal to buy German broadcaster Viva Media, and OSI Pharmaceuticals bought a diabetes drug technology firm Probiodrug of Germany for $35 million. Italian sunglass company Luxottica has bid nearly half a billion dollars to take over U.S.-based Cole National. The deals range in size from tens of millions to hundreds of millions, and cover virtually every major industry: pharmaceuticals and financial services, technology and manufacturing, media and health care.

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Indeed, throughout 2003, foreign direct investment (FDI) in Europe by U.S. companies rose—even as the

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war broke out. According to Daniel Hamilton and Joseph Quinlan of Johns Hopkins University, co-authors of *Partners in Prosperity: The Changing Geography of the Transatlantic Economy,* U.S. FDI in Europe rose 30.5 percent to $87 billion—the highest level ever. That figure represented nearly two-thirds of all U.S. FDI. The main recipients: Germany and France. Meanwhile, European firms in 2003 invested $36.9 billion in the United States, up 42 percent from 2002.

U.S. private equity firms have been particularly active in Europe recently. So far this year, U.S. buyout group Texas Pacific has agreed to buy a chemical business from German coal-miner RAG. Kohlberg, Kravis and Roberts is leading a consortium to purchase Dutch retailer Vendex. The Blackstone Group, which paid $3.8 billion for German chemical company Celanese, is considering setting up an office in Paris. Cerberus and Goldman Sachs' Whitehall Property Fund agreed to pay $2.4 billion to buy a portfolio of apartments from the Berlin city government. Hellman & Friedman, a California-based private equity firm, this summer opened a London office, the better to manage its European investments, which include stakes in German publisher Axel Springer and German broadcaster ProsiebenSat.1 Media AG—and to make new ones.

Meanwhile, European investors have continued to put their euros to work in U.S. markets. In 2003, European investors purchased a net $282.45 billion in American securities—stocks, government bonds, corporate bonds, and other instruments—up 15.8 percent from 2002.

What is it that European and American investors and businesses continue to see in one another? After all, emerging markets like China offer the prospects of greater returns, and Russia and Latin America offer virgin territory for many firms. Well, Americans and Europeans seeking growth and expansion in familiar markets need look

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no further than into one another's eyes. They won't see mirror images. But they will see reflections of themselves: two giant economies in which politics are stable, the rule of law prevails, intellectual property is protected, consumers are wealthy, and the infrastructure is robust.

Since they generally finance acquisitions with debt, buy-out mavens seek stable businesses with relatively predictable cash flows at reasonable prices. Just as Europeans are attracted to the United States because their currency makes them wealthier they moment they set foot here, these opportunistic American investors find Europe at-

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tractive because stocks and companies tend to trade for lower multiples in Europe than in the United States, and because large companies—many of them state-owned—are beginning to restructure.

At the bottom of these trends lies a realization that companies bent on growth have to look beyond their home markets—whether those home markets lie in the United States of America or the somewhat less united states of Europe. For American multinationals such as McDonald's, General Electric, and Coca-Cola, Europe accounts for a disproportionate share of their foreign earnings. For Europe-based multinationals like Unilever, Royal Dutch/Shell, and Siemens, the United States remains the single most important market.

Striking out into new, untested markets can reap large returns. But it also carries the risk of huge losses. And for CEOs who are still shellshocked from late-1990s missteps, investing further in your most profitable markets is the path of least resistance. Quite simply, the U.S.-European trade is where the money is. Today, according to Hamilton and Quinlan, the transatlantic economy generates $2.5 trillion in sales and employs 12 million workers. But some smaller numbers are as impressive, and as telling. Some 6.4 million U.S. workers work for foreign companies; of those, two-thirds are on the payrolls of European-affiliated firms. On the other side of the ledger, some 60 percent of U.S. research and development done outside the United States takes place in Europe.

Painting by the numbers is a primitive form of art. But doing so can allow even unskilled painters to create vivid images. Looking at these numbers, it's hard not to conclude that while some ties between Europe and America may have frayed in recent years, the cords that link the world's two most powerful economies and markets together have been quietly strengthening. ◆