AmChams in Europe

The Case for Investing in Europe 2014

Why U.S. firms should stay the course

Joseph P. Quinlan

Preface and Acknowledgements

The case for investing in Europe remains as strong as ever. Defying the disbelievers, Europe (in general) emerged from recession in 2013 and is poised to expand over the near-term. Granted, it's not all clear sailing from here. But owing to painful structural reforms in the periphery, thanks to a forward-looking European Central Bank and with the benefit of accelerating global growth, Europe's economy is on the mend. A more favorable business climate has emerged across Europe—notwithstanding simmering geo-political tensions in Ukraine.

Even though the ascendency of China and the BRICs remains the popular narrative, two points are worth emphasizing. First, the BRICs are struggling to find a new and sustainable growth model, notably China, where growth has slowed significantly from the historic average. Two, while the business climate in developing nations remains challenging, Europe is set to remain one of the largest and wealthiest economic entities in the world. As such, American firms that wish to have a truly global reach cannot afford to be absent Europe and miss out on what the region offers—a wealthy consumer base, a skilled labor force, and well developed technological and innovative clusters.

The value of Europe lays not only in its economy, but also in its periphery. Europe's neighborhood—which includes Russia in the north, Turkey to the east, and Middle East and Africa to the east and south—represents one of the most dynamic and promising areas of the global economy. This, despite ongoing political "hot spots" that are expected to dissipate over the medium term. By being present in the European market, U.S. firms enjoy preferential and easy access to this up-and-coming part of the world.

Highly profitable U.S. foreign affiliates in Europe are also extremely important to the overall success of their parent companies and the health of the U.S. economy. The profitability of U.S. affiliates in Europe allows parents to use the higher available earnings to hire and invest at home, dole out higher wages to U.S. workers, and/or increase dividends to company shareholders.

I would like to thank AmChams in Europe, the network of 45 American Chambers of Commerce across Europe for spearheading this project and for their input and insight in putting together this report. I also want to thank the companies that provided case studies for this report—their input helps to bring to life what statistics cannot. Thank you to AmCham EU for their work in producing this report. The views expressed here are my own, and do not necessarily represent those of AmChams in Europe.

Joseph P. Quinlan
Transatlantic Fellow at the Center for Transatlantic Relations, Johns Hopkins, and the German Marshall Fund, Washington, DC.

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Editor and Project Manager
Giovanni Mastrobuono (Senior Communications Officer, AmCham EU)

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AmChams in Europe (European Council of American Chambers of Commerce)
c/o AmCham EU
Avenue des Arts 53
B-1000 Brussels
Belgium
T +32 (0)2 289 10 14
E ecacc@amchameu.eu
www.amchamsineurope.com

What's right with Europe
Defying the sceptics, Europe emerged from recession in 2013 and is poised to expand by 1-2% over the near term. Even allowing for the last four years of sluggish real growth, the EU remains one of the largest economic entities in the world.

The aggregate output of the EU was estimated at roughly $16.2 trillion in 2013 (PPP). The EU's economy is roughly 20% larger than China's and 3.5 times larger than India's.

In 2013, Europe (the EU28 plus Europe's extended periphery) accounted for around 28.5% of global personal consumption expenditures, a share slightly higher than America's (26.6%) and well above the level of the BRICs combined consumption (15.6%).

In the 2014 Ease of Doing Business rankings, 13 European economies ranked in the top 25 most business-friendly nations. Denmark ranked 5th overall, followed by Georgia (8th), Norway (9th), the United Kingdom (10th), Finland (12th), Iceland (13th), Sweden (14th), Ireland (15th), Lithuania (17th) Germany (21st), Estonia (22nd), Latvia (24th), and Macedonia (25th).

Many European economies remain among the most competitive in the world. In the latest rankings of global competitiveness from the World Economic Forum, six European countries were ranked among the top 10, and six more among the top twenty-five.

According to the National Science Board, of the world's global research pool, the EU housed 1.6 million researchers in 2013 versus 1.3 million in the United States.

The China next door
Roughly 11% of corporate America's European workforce is now based in central and eastern Europe, up from virtually zero two decades ago. Affiliate employment in central and eastern Europe expanded at an average annual pace of 8.7% between 1999-2010 versus a comparable 0.8% rate in western Europe.

Reflecting many variables—greater employment, rising incomes, and most of all, pent up demand for western goods after decades of denial—personal consumption in central and eastern Europe doubled between 1990 and 2005 and then nearly doubled again by 2012. Consumption totaled an estimated $2.7 trillion in 2013.

Consumer spending in China ($3 trillion in 2012) was just 15% larger than the combined personal consumption expenditures in developing Europe (Russia included). Spending in the latter, however, was more than double the level of consumer expenditures in India—$2.6 trillion versus $1.1 trillion.

Europe's extended periphery is massive in size and scale. Indeed, the total output of this geographic cohort is slightly larger than China's total output. In 2013, the periphery nations produced $13.5 trillion in output versus China's $13.4 trillion (numbers are based on PPP).

In the aggregate, Europe's periphery consumed an estimated $3 trillion in goods imports in 2013—a figure greater than imports of China and a figure larger than the world's top importer of goods, the United States.

Why Europe still matters
For firms in the S&P 500, foreign sales in Europe as a percentage of the foreign total (roughly 21% in 2012) was greater than in Asia (16%) and South America (less than 6%).

Since 2000, and on a cumulative basis, Europe has attracted roughly 56% of total U.S. foreign direct investment outflows.

Rising U.S. foreign affiliate earnings in Europe have underpinned more output and employment growth in Europe, more R&D expenditures across the continent, and more bi-lateral trade not only between the U.S. and EU but also between the EU and many other parts of the world.

U.S. foreign affiliates in Europe have long been agents of growth in virtually every country they have operated in; the gross output of American affiliates in Ireland now represents roughly one-quarter of the nation's gross domestic product, a staggering sum and presence of U.S. affiliates.

A U.S.-EU free trade agreement: a potential global game changer
Momentum is building for a new and comprehensive free trade agreement between the United States and the European Union. Such a deal would not only boost growth on both sides of the Atlantic but also strengthen the U.S.-EU economic axis relative to the developing nations and key emerging powers like China.

A transatlantic free trade pact would not only be about reducing tariffs. It would also be about reducing non-tariff barriers and harmonizing the web of regulatory standards that inhibit transatlantic trade and investment flows and add to the cost of doing business on both sides of the ocean.

At a broad and macro level, a study by the European Commission found that eliminating or harmonizing half of all remaining tariffs and non-tariff barriers on bi-lateral trade could add up to 1.5% points to growth over the medium term on both sides of the ocean.

A free trade deal would help create jobs and income on both sides of the pond, and spur more cross-border trade and investment in goods and services. The more far-reaching the agreement, the greater the impact on key sectors of the transatlantic economy, notably in services where there is plenty of scope for further integration.

Chapter 1

What's right with Europe

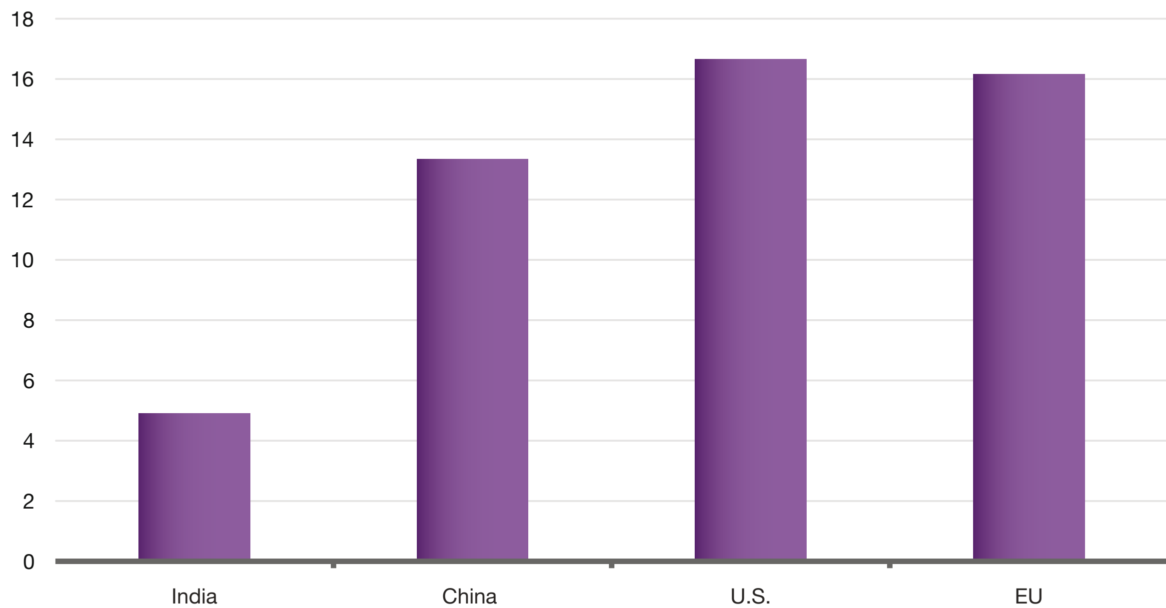
Defying the skeptics, Europe emerged from recession in 2013 and is poised to expand by 1-2% over the near term. The latter figure is hardly "robust" and in reality the challenges before Europe are substantial. Undercapitalized banks, massive debt loads, uncompetitive economies and industries, stubbornly high levels of unemployment—these remain serious issues for many nations in Europe.

But the cyclical economic rebound will assist in addressing many of these issues, as will the fundamental strengths of Europe—strengths that have been all but forgotten during the past few years of crisis. On balance, there is plenty right with Europe, giving plenty of reasons for U.S. firms to stay the course in Europe.

First, even allowing for the last four years of sluggish real growth, the European Union remains one of the largest economic entities in the world. By breaking down barriers to trade and investment, by allowing for the free flow of capital and people, by opting for a Single Market and a single currency in many cases, by embracing these and other strategies/policies over the past few decades—the sum of Europe's parts are sizable relative to other competing economic entities in the world.

No American firm can afford to be absent from a market that is roughly the size of the entire U.S. economy. What started out as a loosely configured market of six nations (Belgium, France, West Germany, Italy, Luxembourg, and the Netherlands) in the late 1950s is now an economic behemoth of 28 member states, with Croatia joining the club in 2013 and more states waiting to join.

EU GDP versus U.S., China and India
(Trillions of U.S. $, based on purchasing power parity)



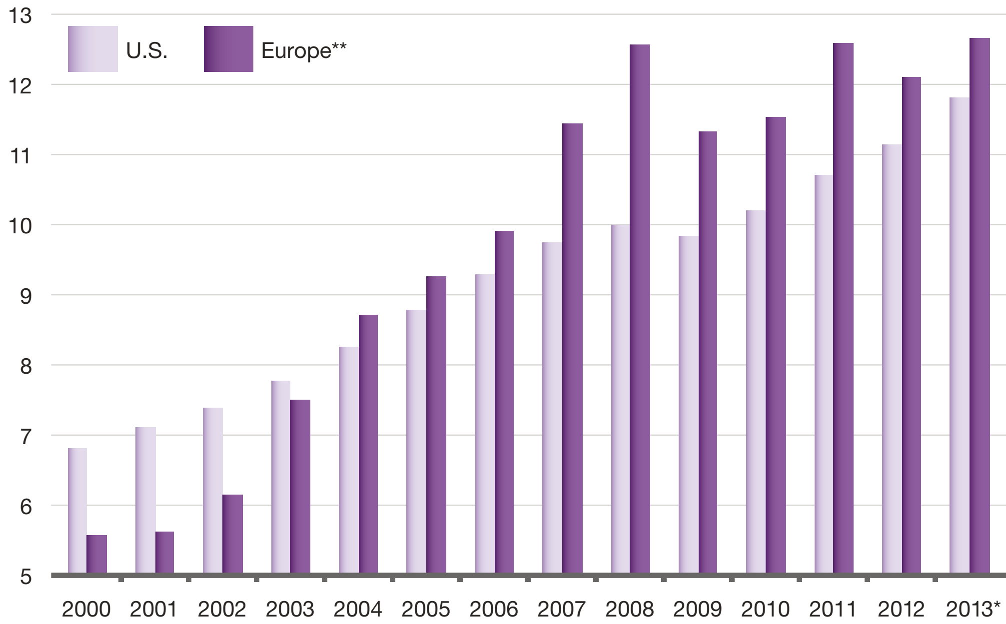
Source: International Monetary Fund *Estimates for 2013*

The aggregate output of the EU was estimated at roughly $16.2 trillion in 2013 (based on a purchasing power parity (PPP) basis). To put that figure into perspective, the EU's economy is roughly 20% larger than China's and 3.5 times larger than India's. While Asia's twin giants are expanding at a faster rate than the EU, the global economic clout of Europe—here, now, and in the future—remains immense.

Second, Europe is not only among the largest economic entities in the world, it is also among the wealthiest. It is Europe's size and wealth that sets the region apart from many other parts of the world, the United States included.

In 2013, Europe (the EU28 plus Europe's extended periphery) accounted for around 28.5% of global personal consumption expenditures, a share slightly higher than America's (26.6%) and well above the level of the BRICs combined consumption (15.6%). Gaining access to wealthy consumers is among the primary reasons why U.S. companies venture overseas, and hence the continued attraction of Europe to U.S. firms.

The European Consumer is Mightier than the U.S. Consumer
(Household consumption expenditures, trillions of U.S. $)

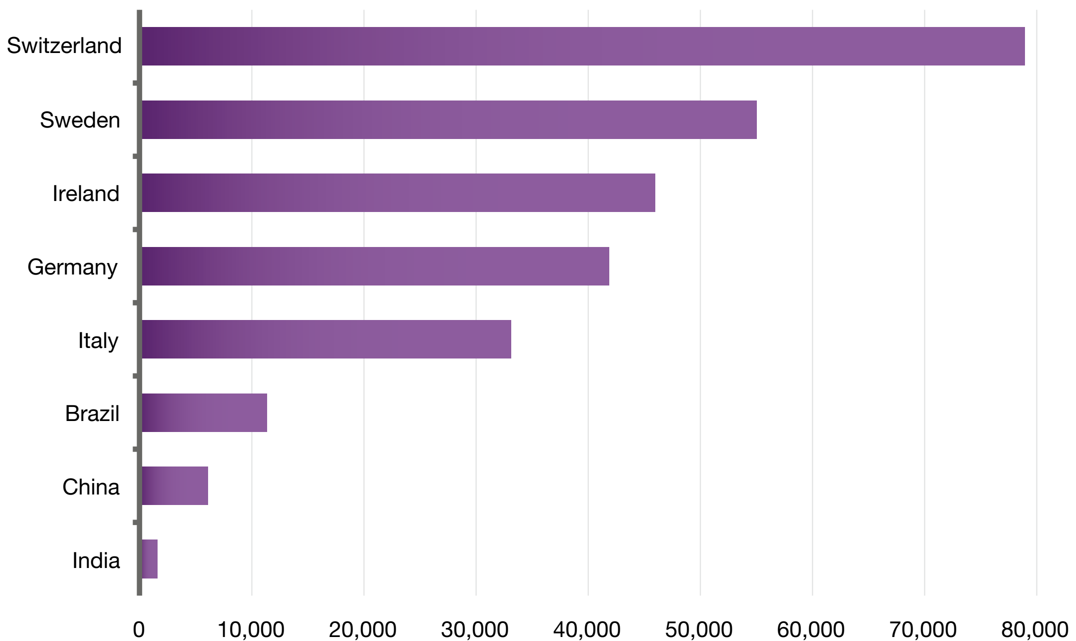


*Estimate
**Europe==EU28 plus Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Georgia, Iceland, Macedonia, Moldova, Montenegro, Norway, Russia, Serbia, Switzerland, Turkey, and Ukraine

Source: United Nations

While much has been made of the rise of China, with the mainland's economy now the second largest in the world, the Middle Kingdom remains relatively poor, with China's per capita income totaling just $6,091 in 2012, according to figures from the World Bank. The figure ranks 83rd in the world and is well below the per capita income levels of Sweden ($55,401), the Netherlands ($45,955), Ireland ($45,932), Germany ($41,863), and the EU average of $32,782 in 2012. With a miserly per capita income of $1,489, India ranks 136th.

The Wealth of Nations
(GDP per capita, U.S. $)



Source: World Bank Data for 2012

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The equation to what's right with Europe begins with the following: **economic size + per capita wealth = large markets for the goods and services of U.S. firms**.

To the above must be added a third element that supports what's right with Europe—the ease of doing business is generally better in Europe than many other parts of the world.

Remember: the rate by which a particular economy grows and expands certainly matters to U.S. multinationals and hence the attraction towards the super-charged economies of China, Brazil, and India, that incidentally are not so "supercharged" anymore. Growth in all three nations, notably Brazil and India, has slowed dramatically over the past year; the high flyers are now low flyers.

Just as the macroeconomic backdrop influences any business climate, so do micro factors. Country and industry regulations can help or hamper the foreign activities of U.S. multinationals and greatly influence where U.S. companies invest overseas. Think property rights, the ability to obtain credit, regulations governing employment, the time it takes to start a business, contract enforcements, and rules and regulations concerning cross border trade. These and other metrics influence and dictate the ease of doing business, and on this basis many European countries rank as the most attractive in the world.

The World Bank annually ranks the regulatory environment for domestic firms in 185 nations, a ranking which serves as very good proxy for the ease of doing business for domestic and foreign companies alike. In the 2013/14 rankings, 13 European economies ranked in the top 25 most business-friendly nations. Denmark ranked 5th overall, followed by Georgia (8th), Norway (9th), the United Kingdom (10th), Finland (12th), Iceland (13th), Sweden (14th), Ireland (15th), Lithuania (17th), Germany (21st), Estonia (22nd), Latvia (24th) and Macedonia (25th). Out of the top 50 rankings, European firms made up nearly half, with 24 nations placed in the top fifty.

Outliers include Italy (65th), Greece (72nd), Croatia (89th), Russia (92nd), and Serbia (93rd). Reflecting the challenging business environment of many key emerging markets, China ranked 96th in terms of ease of doing business in 2013, while India ranked 134th and Brazil clocked in at 116th.

Global Ease of Doing Business Rankings: The Top 25

Rank	Country
1	Singapore
2	Hong Kong
3	New Zealand
4	United States
5	Denmark
6	Malaysia
7	Korea
8	Georgia
9	Norway
10	United Kingdom
11	Australia
12	Finland
13	Iceland
14	Sweden
15	Ireland
16	Taiwan
17	Lithuania
18	Thailand
19	Canada
20	Mauritius
21	Germany
22	Estonia
23	United Arab Emirates
24	Latvia
25	Macedonia

Source: World Bank *Data as of October 2013*

The nations just mentioned are regularly hyped as among the most dynamic in the world, yet strong real GDP growth does not necessarily equate to a favorable environment for business. Other elements need to be factored into the equation, like the rise of state capitalism in many developing nations, continued intellectual property right infringements, capital controls, and discriminating domestic policies against foreign firms. These factors have become favorite policy tools in many key emerging markets, further enhancing the attractiveness of Europe in the eyes of U.S. multinationals.

In the end the greater the ease of doing business in a country, the greater the attractiveness of that nation to U.S. firms. The microclimate matters just as much as the macro performance; Europe trumps many developing nations by this standard.

Fourth, Europe's sovereign debt crisis has obscured a critical fact about the region's global competitiveness: notwithstanding current market problems, many European economies remain among the most competitive in the world. For instance, in the latest rankings of global competitiveness from the World Economic Forum, six European countries were ranked among the top 10, and six more among the top 25. Switzerland ranked first, Finland 3rd, Germany 4th, Sweden 6th, the Netherlands 8th, and the United Kingdom 10th. Meanwhile, Norway ranked 11th, Denmark ranked 15th, Austria 16th, Belgium 17th, Luxembourg 22nd, and France 23rd. The United States, by way of comparison, ranked 5th.

At the other end of the spectrum, a handful of European nations scored poorly, underscoring the fact that Europe's competitiveness is hardly homogenous. Seven nations did not even score in the top fifty, with Greece ranking 91st in the latest survey, the worst performer among EU members.

The spread between first place Switzerland and floundering Greece underscores the divergent competitiveness of the EU and highlights the fact that various nations exhibit various competitive strengths and weaknesses. For instance, Greece received low marks for its public institutions and inefficient labor markets, which stands in contrast to Ireland's well functioning labor force or Norway's highly ranked public institutions.

Belgium was cited for outstanding health indicators and primary education; France was highlighted for its transport links and energy infrastructure, as well as strengths in quality of education, sophistication of business culture, highly developed financial markets, and leadership in innovation. Estonia, Poland, and the Czech Republic were cited for their top-notch education system and flexible labor markets; Spain's ranking was hurt by macroeconomic imbalances but helped by ICT usage. Italy's labor force remains quite rigid but the nation scored well in terms of producing goods high up in the value chain. Finally, Germany ranked highly across many variables: quality of infrastructure, efficient goods market, R&D spending, exports, and large domestic market, among other things.

Top 30 Rankings in the Global Competitiveness Index 2013-2014

Economy	Rank	Score
Switzerland	1	5.67
Singapore	2	5.61
Finland	3	5.54
Germany	4	5.51
United States	5	5.48
Sweden	6	5.48
Hong Kong SAR	7	5.47
Netherlands	8	5.42
Japan	9	5.40
United Kingdom	10	5.37
Norway	11	5.33
Taiwan	12	5.29
Qatar	13	5.24
Canada	14	5.20
Denmark	15	5.18
Austria	16	5.15
Belgium	17	5.13
New Zealand	18	5.11
United Arab Emirates	19	5.11
Saudi Arabia	20	5.10
Australia	21	5.09
Luxembourg	22	5.09
France	23	5.05
Malaysia	24	5.03
Korea	25	5.01
Brunei Darussalam	26	4.95
Israel	27	4.94
Ireland	28	4.92
China	29	4.84
Puerto Rico	30	4.67
Iceland	*31*	*4.66*
Estonia	*32*	*4.65*
Spain	*35*	*4.57*

Data as of September 2013 *Source: World Economic Forum: Global Competitiveness Report 2013-2014*

Moreover, although the overall U.S. ranking was quite high, it lagged behind many European nations when it came to infrastructure, health and primary education, and technology readiness. Per the latter, the U.S. ranked 15th—a decent score. But European nations ranked even better when it came to technology readiness: Sweden (1st), Norway (3rd), the United Kingdom (4th), Switzerland (9th), Finland (11th), Ireland (13th), and Germany (14th). Under the category "health and primary education", the U.S. ranked 34th, lagging Finland (ranked 1st), Switzerland (12th), Sweden (13th), the United Kingdom (16th), and Italy (26th). In terms of quality of infrastructure, the U.S. ranked 15th, well behind many European states like Germany (3rd), France (4th), Switzerland (6th), the Netherlands (7th), the United Kingdom (8th), and Spain (10th).

All of the above is another way of saying that there is a great deal more to Europe than the daily diet of negative headlines. The various nations of Europe offer specific micro capabilities/competencies that are lacking on a relative basis in the U.S. and critical to the global success of U.S. firms.

Fifth, Europe is no slouch when it comes to innovation and knowledge-based activities. Based on the Innovation Union Scoreboard for 2014, Denmark, Finland, Germany, and Sweden rank as innovation leaders in Europe.

According to the 2014 data, the performance of Sweden ranked first in the survey, followed by Germany, Denmark, and Finland. These are the most innovative states in the EU, performing well above that of the EU28 average. Hence, this group was dubbed “Innovation Leaders”.

So-called “Innovation Followers” include Austria, Belgium, Cyprus, Estonia, France, Ireland, Luxembourg, the Netherlands, Slovenia, and the UK. The performance of Croatia, the Czech Republic, Greece, Hungary, Italy, Lithuania, Malta, Poland, Portugal, Slovakia, and Spain were below the EU average; these nations are considered moderate innovators. The laggards, or modest innovators, include Bulgaria, Latvia, and Romania.

While significant discrepancies exist among nations in the EU as to knowledge-based capabilities, the innovation performance of the EU remains ahead of Australia, Canada, and all BRIC nations. In addition, based on the latest figures, the EU is closing its performance gap with Japan and the United States.

In that R&D expenditures are a key driver of value-added growth, it is interesting to note that Europe-based companies accounted for roughly 22-23% of total global R&D in 2012 and 2013. That lagged the share of the United States (34% in 2013) but was well ahead of the global share of R&D spending in Japan (10.5%), China (16.5%), and India (2.9%). In 2013, Sweden, Switzerland, Finland, and Denmark spent more on R&D as a percentage of GDP than the United States.

Led by European industry leaders like Volkswagen, Roche, Novartis, Daimler, Sanofi, GlaxoSmithKline, and Nokia, Europe remains a leader in a number of cutting edge industries including life sciences, agriculture and food production, automotive, aerospace, nanotechnology, energy, and information and communications. The European firms just listed are part of the Innovation Top 20; note from the table that seven out of the top 20 are European firms, underscoring the innovative culture and capabilities of Europe’s corporate giants.

Top 20 Innovative Companies in the World

		R&D Spending			
Rank 2013	**Company**	**2013, U.S.$ Billions**	**Change from 2012**	**Headquarters Location**	**Industry**
1	Volkswagen	11.4	22.4%	Europe	Auto
2	Samsung	10.4	15.6%	South Korea	Computing and Electronics
3	Roche Holding	10.2	14.7%	Europe	Healthcare
4	Intel	10.1	21.5%	North America	Computing and Electronics
5	Microsoft	9.8	8.5%	North America	Software and Internet
6	Toyota	9.8	3.5%	Japan	Auto
7	Novartis	9.3	-2.6%	Europe	Healthcare
8	Merck	8.2	-3.5%	North America	Healthcare
9	Pfizer	7.9	-13.3%	North America	Healthcare
10	Johnson & Johnson	7.7	1.6%	North America	Healthcare
11	General Motors	7.4	-9.3%	North America	Auto
12	Google	6.8	31.6%	North America	Software and Internet
13	Honda	6.8	7.8%	Japan	Auto
14	Daimler	6.6	3.2%	Europe	Auto
15	Sanofi	6.3	2.3%	Europe	Healthcare
16	IBM	6.3	0.7%	North America	Computing and Electronics
17	GlaxoSmithKline	6.3	-1.0%	Europe	Healthcare
18	Nokia	6.1	-14.4%	Europe	Computing and Electronics
19	Panasonic	6.1	-3.5%	Japan	Computing and Electronics
20	Sony	5.7	9.3%	Japan	Computing and Electronics
	Top 20 Total	**159.2**	**4.6%**		

Source: Booz & Company

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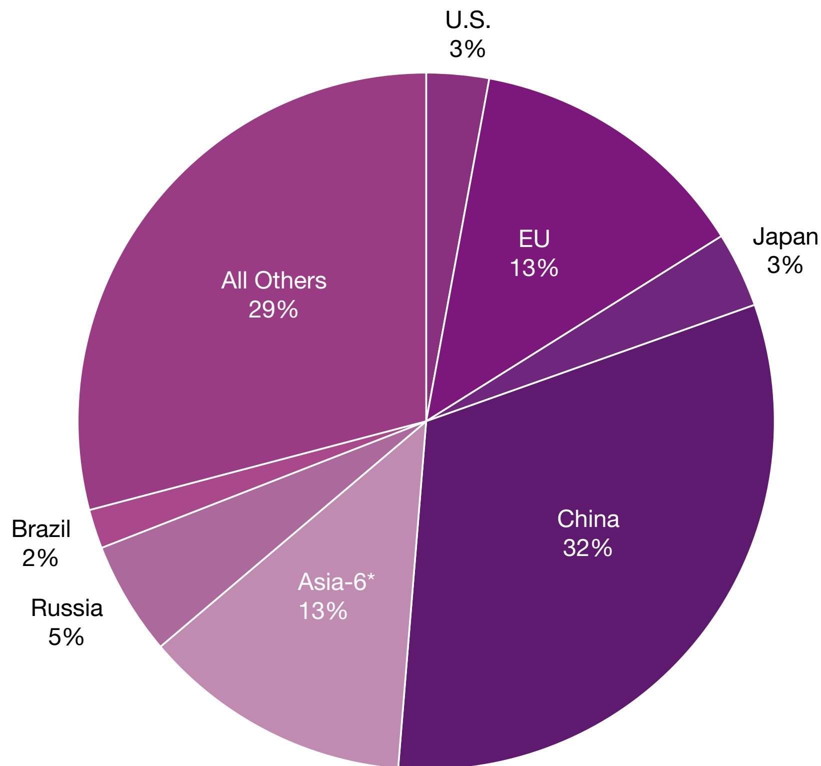
Innovation requires talent and on this basis, Europe is holding its own relative to other parts of the world. To this point, Europe leads the world in producing science and engineering graduates, with the EU, according to the latest data from the National Science Board, accounting for 13% of global engineering graduates in 2013. America's share was just 3% of the global total.

According to National Science Board, of the world's global research pool, the EU housed 1.6 million researchers in 2013 versus 1.3 million in the United States. The EU accounted for 26% of the global total.

Europe Leads the Way: Number of First University Degrees (engineering)
(% of global total)



***Asia-6: India, Malaysia, Philippines, Singapore, South Korea, and Taiwan*

Source: Organisation for Economic Co-operation and Development: Science and Engineering Indicators, 2014

In specific industries, the EU remains notably strong in such high-technology manufacturing industries as pharmaceuticals, scientific instruments and aerospace. Against this backdrop, the EU is the largest exporter of commercial knowledge-intensive services (excluding intra-EU exports). Supporting Europe's top position in service-related exports is the fact that among other regions of the world, Europe is the most globally connected based on the DHL Global Connectedness Index for 2012.

The 2012 DHL Global Connectedness Index, Overall Results
(Country rankings)

Rank	Country
1	Netherlands
2	Singapore
3	Luxembourg
4	Ireland
5	Switzerland
6	United Kingdom
7	Belgium
8	Sweden
9	Denmark
10	Germany
20	United States
	BRICs
62	India
68	Russia
74	China
77	Brazil

Source: DHL *Data as of April 2013*

The Coca-Cola Company

Focus: The Coca-Cola Company

Coca-Cola has been an integral part of the European economy for more than 100 years, including local bottling operations from as early as 1927. Coca-Cola's bottling system currently has 102 plants in 32 European countries, employing about 54,000 people.

Coca-Cola's indirect economic impact is much higher, due to the very local nature of their supply and distribution chains. From the farmers growing beets in France, oranges in Greece and apples in Central Europe, to young marketers and designers in London or Berlin to the tapas bar owner or the small corner shop serving Coca-Cola beverages in Spain or Italy, The Coca-Cola Company supports more than 656,000* jobs throughout Europe.

In terms of value, European consumers enjoy more than 16 million 250ml servings per day out of a portfolio of 140 brands and 750 different beverages. This makes Europe a very important market for the company, representing its most important geographical group in terms of value. Europe generates about 28% of their worldwide operating income – and for every euro they make, European companies in their supply chain make €2 of profit.

Coca-Cola and its bottling partners directly add €3.7 billion to the European economy (in terms of local salaries, tax payments and profits) and its supply chain supports almost €32 billion(*) in economic value-added to the continent.

But the importance of Europe for Coca-Cola goes well beyond the sheer numbers of their business. Thanks to its vibrant society, continent-wide rules and regulations, educated workforce and trend-setting culture, Europe is, and will continue to be, a great source of innovation for Coca-Cola - from the creation of global brands such as Fanta to the launch of innovative reduced-calories beverages such as Sprite with Stevia.

Macroeconomic conditions in Europe are certainly challenging, but the brand love associated with Coca-Cola and their ability to offer consumers affordable daily pleasures will allow them to continue investing in the market and continue to grow and contribute to the economic future of the continent.

*Based on independent studies conducted in 2012 by Prof. Ethan B. Kapstein (Georgetown University – Washington DC) in collaboration with Dr. René Kim, Ms. Hedda Eggeling MSc, Mr. Willem Ruster MSc, Mr. Tias van Moorsel MSc and Ms. Teodora Nenova MSc of Steward Redqueen in Haarlem (The Netherlands).

Finally, in terms of future workers, the U.S. high school graduation rate lags behind most European nations; indeed, the U.S. ranked 22nd of 25 OECD nations for graduation rates in 2008, trailing such EU states as Germany, Ireland, Finland, Greece, Norway, the UK, Switzerland, Iceland, the Czech Republic, Italy, Denmark, Poland, Slovakia, and Hungary. The U.S. graduate rate is 77% versus an OECD average of 83%.

While U.S. universities remain a top destination for foreign students, the UK, Germany, and France are also notable attractions. In the end, Europe remains among the most competitive regions in the world in terms of science and technology capabilities. According to the U.S. National Science Board, "EU research performance is strong and marked by pronounced EU-supported, intra-EU collaboration."[1]

A final point to consider regarding what's right with Europe: while hard to fathom given the blizzard of bad news emanating from the region over the past few years, there is still a chance the Eurozone and EU will emerge stronger, not weaker from the crisis.

Time will only tell. However, the crisis has been a catalyst for the gradual adoption and pursuit of measures that will, over time, increase the level of cooperation and coordination among European states, strengthen the mechanics of the Growth and Stability Pact, and nudge Europe ever closer towards a fiscal union. The infrastructure is being put in place that will increase the transparency and accountability of member state's fiscal and macroeconomic policies, with the expectation that future potential crises will be avoided.

In short, albeit slowly and haltingly, the institutions, mechanisms, and policies that will make Europe stronger and more integrated in the future are being adopted.

Think of it this way: the financial crisis has forced Europe to rethink and address the design flaws and shortcomings of the single currency, of which there are many. Europe's monetary union was adopted without a corollary economic union, lacking a fiscal union, appropriate governing institutions, and mechanisms to coordinate economic policies. And compounding matters, the Stability and Growth Pact that was intended to impose budget discipline on member states and promote sound public finances was rendered less effective when France and Germany, confronting widening deficits, watered down many of the rules and regulations of the Pact.

Technology/Innovation Comparisons: Europe vs. the U.S.
(Relative technological advantage indices by sector, ratio, 2007)

	Europe	United States
Aerospace and defense	1.5	1.1
Automobiles and parts	1.3	0.6
Biotechnology	0.3	2.2
Chemicals	1.3	0.6
Commercial vehicles and trucks	1.3	1.1
Computer hardware and services	0.1	1.4
Electrical components and equipment	1.6	0.2
Electronic equipment and electronic office equipment	0.2	0.4
Fixed and mobile telecommunications	1.5	0.2
Food, beverages, and tobacco	0.9	0.7
General industrials	0.6	1.5
Health care equipment and services	0.7	1.9
Household goods	0.8	1.6
Industrial machinery	1.8	0.2
Industrial metals	1.0	0.3
Internet	0.0	2.5
Oil	1.0	0.9
Personal goods	1.4	0.7
Pharmaceuticals	1.3	1.2
Semiconductors	0.5	1.7
Software	0.5	2.1
Support services	0.8	1.2
Telecommunications equipment	1.4	1.1

Data as of January 2012 *Source: World Bank: Golden Growth: Restoring the Lustre of the European Economic Model*

Today, however, the facilities that were lacking at the outset of the monetary union are now being put in place, including an agreement on a permanent EU crisis fund; a stronger and more proactive European Central Bank; greater intra-Europe coordination and enforcement of fiscal policies (the fiscal compact); and stricter macroeconomic surveillance. Meanwhile, Europe's heavily indebted nations are taking painful steps to rein in spending, boost productivity, increase labor market flexibility, and other structural reforms.

In the long run, these measures, combined with labor and industry reform at the national level, will ultimately give Europe a sturdier foundation by which to operate and grow.

After all the drama of the past few years, the Europe that evolves and emerges from the crisis will be more politically and economically integrated, and therefore an even more attractive place to do business.

Adding it all up

Europe, long the weak link of the global economy, is in recovery mode and remains a formidable economic entity. While the crisis has battered the global brand of Europe, the region remains quite large, wealthy, richly endowed, open for business, and technologically out in front in many key global industries.

Because of all of this, Europe will remain a critical and indispensible geographic node in the global operations of U.S. companies. American multinationals increasingly view the world through a tri-polar lens—a world encompassing the Americas, Europe, and Asia, along with attendant offshoots. In this tri-polar world, U.S. companies are not about to give up on or decamp from one of the largest segments of the global economy.

1 See the National Science Board's "Science and Engineering Indicators, 2012," pp 1-3.

Focus: Eli Lilly

Eli Lilly and Company has had a significant presence in Europe since its first overseas subsidiary was established in the UK in 1934. Lilly has doubled annual research and development (R&D) investments in Europe over the past 10 years to over €450 million and they now employ around 9,000 people across the region.

Lilly has two major research sites in Europe, in the UK and Spain, in addition to an extensive manufacturing network. Approximately one third of their worldwide clinical trials take place in Europe, representing a total investment of nearly €125 million per year.

Their European manufacturing sites are important exporters to other parts of the world. Their Spanish site, for instance exports to over 120 countries worldwide and 92% of their French site production is exported to over 100 countries on five continents.

Lilly's research center in the UK is home to many of their pioneering innovations, and a center of excellence in neuroscience. There are currently over 600 people working on the site, with over 45 nationalities working across more than 30 disciplines. Lilly supports the Innovative Medicines Initiative, a joint project of the EU and the European Federation of Pharmaceutical Industries and Associations, the largest private-public partnership in Life Science R&D with active participation in some 17 projects for diabetes, neuroscience and oncology, and more than €20 million in investments.

Lilly is committed to bringing life-changing medicines to those who need them in Europe, advancing the understanding and management of disease, and providing meaningful support to patients living with illness and to the people who care for them.

Facing the challenges of the day, and continuing on the journey of innovation, requires an environment in which innovation can flourish. This includes pricing and reimbursement systems that reflect the value of new medicines, ensure swift access and uptake, and deliver broad access for patients. Robust collaboration between industry, governments and academia is vital. Without a supportive and collaborative environment, biopharmaceutical innovation would simply wither.

Lilly strongly supports the negotiations for the Transatlantic Trade and Investment Partnership. The pharmaceutical markets in the US and the EU remain among the most significant in the world. The trade agreement has the potential to deliver new opportunities to extend patient access to innovative medicines and to strengthen R&D on both sides of the Atlantic.

For Lilly, the potential deal also offers the chance to better meet patients' needs by mutually recognizing high quality standards for manufacturers and by harmonizing regulatory procedures. This, in turn, can contribute to reducing the time it takes to bring quality medicines to market.

Chapter 2

The China next door

One more thing that is right about Europe

Large, wealthy, competitive, well endowed with critical inputs—these key attributes underpin the attractiveness of the EU to corporate America. Yet to this list another item must be added: Europe's large and expanding economic periphery, encompassing not only central and eastern Europe, Russia included, but also Turkey, the Middle East, North Africa and sub-Saharan Africa. Notwithstanding a few geo-political "hotspots" in Europe's periphery, the majority of economies are expanding and becoming more integrated, not less, with Europe in particular and the global economy in general.

The EU is an unusual blend of developed market economies (the EU15) and developing markets (the EU13), and when fused, the two halves offer some of the best commercial opportunities in the world. The EU13 members, for clarification, include many nations that joined the EU over the past decade via the EU enlargement process, with Croatia the latest entrant.

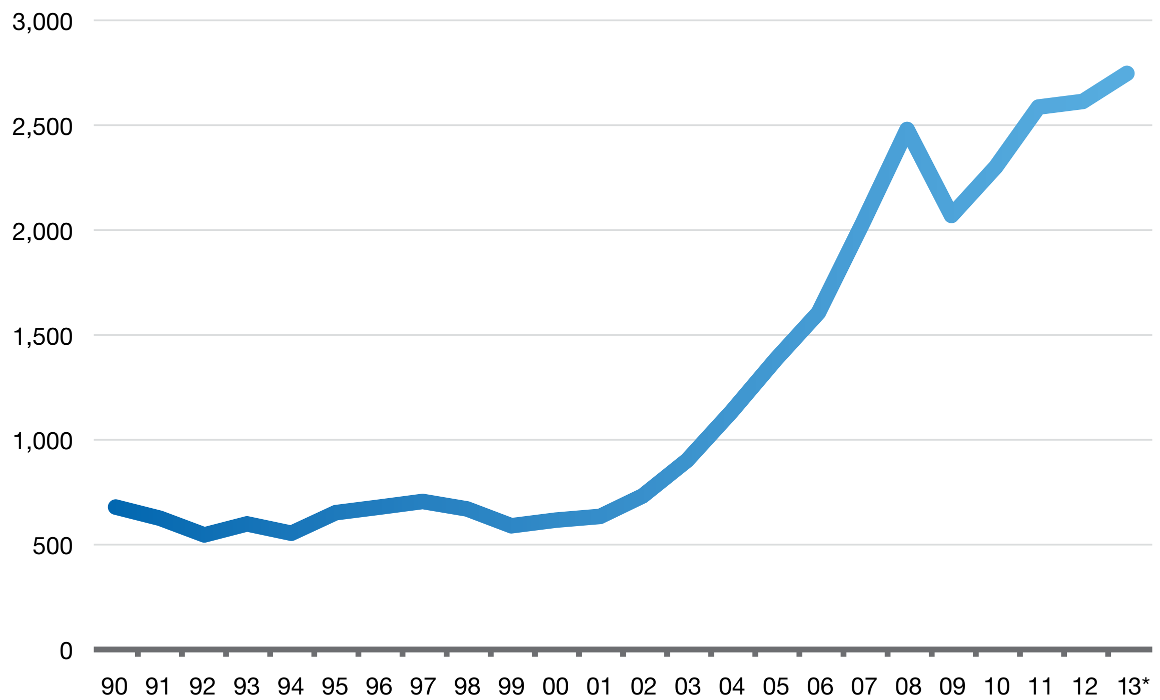
The alchemy of western and eastern/central Europe has been hugely beneficial to those U.S. firms embedded in the EU. EU enlargement has meant not only the geographic extension of Europe but also the enlargement of market opportunities, resources, and profits in the east for U.S. multinationals.

Poland, the Czech Republic, Slovakia, and other states in the region represent new and untapped markets and a lower wage base that U.S. firms have been quick to leverage. To the latter point, roughly 11% of corporate America's European workforce is now based in central and eastern Europe, up from virtually zero two decades ago. Affiliate employment in central and eastern Europe expanded at an average annual pace of 8.7% between 1999-2010 versus a comparable 0.8% rate in western Europe.

According to most recent figures, there are more Polish manufacturing workers on the payrolls of U.S. foreign affiliates (roughly 100,000 workers) than manufacturing workers employed by affiliates in Spain (86,500), Ireland (52,200), or even Japan (77,000) and South Korea (57,000) for that matter.

Meanwhile, while EU enlargement has given U.S. firms access to a relatively large pool of skilled and low-cost labor, it has also given companies access to new consumers. Consumerism—as measured by personal consumption expenditures—has simply soared over the past decade in the east.

Making Up For Lost Time: Personal Consumption in Developing Europe**
(Billions of U.S. $)



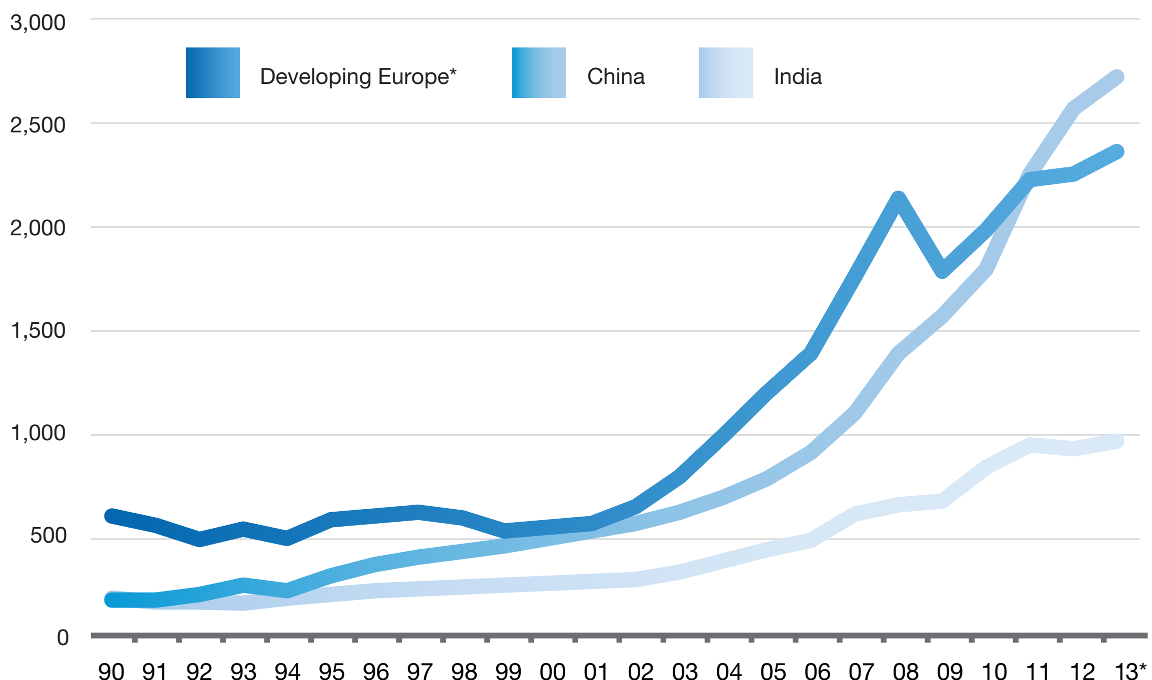
**Estimate*
***Developing Europe includes EU-13 plus Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Georgia, Macedonia, Moldova, Montenegro, Russia, Serbia, Turkey, and Ukraine*

Source: United Nations

Indeed, reflecting many variables—greater employment, rising incomes, and most of all, pent up demand for western goods after decades of denial—personal consumption in central and eastern Europe doubled between 1990 and 2005 and then nearly doubled again by 2012, when expenditures totaled an impressive $2.6 trillion. That is not bad for a part of the world largely cut off from the global markets during the Cold War. In 2013, consumption totaled an estimated $2.7 trillion.

More impressive still is this: the consumer in developing Europe spends nearly as much as consumers in China and easily outspends consumers in India. To this point, consumer spending in China ($3 trillion in 2012) was just 15% larger than the combined personal consumption expenditures in developing Europe (Russia included). Spending in the latter, however, was more than double the level of consumer expenditures in India–$2.6 trillion versus $1.1 trillion.

The China Next Door: Personal Consumption in Developing Europe versus China/India**
(Billions of U.S. $)



**Estimate*

***Developing Europe includes EU-13 plus Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Georgia, Macedonia, Moldova, Montenegro, Russia, Serbia, Turkey, and Ukraine*

Source: United Nations

In the end, consumption is serious business in central and eastern Europe, with consumption accounting for over 55% of GDP in 2012. That compares to a figure of 45% in more trade-dependent Asia and less than 40% in China.

Rising levels of consumer spending, not surprisingly, have translated into the ever-rising sales revenues of U.S. foreign affiliates. Combined U.S. foreign affiliate sales in Poland, Hungary, and the Czech Republic surged roughly 270% between 2000 and 2011, rising from $21 billion to $77.6 billion. The latter figure, incidentally, was roughly one-third larger than affiliate sales in India, home to a population of 1.2 billion people versus a total population of roughly 60 million in Poland, the Czech Republic, and Hungary. What U.S. affiliates reported as income in Poland in 2012—$732 million—was well above levels reported in the more developed markets of Finland, Portugal, Spain, and Sweden.

In the end, EU enlargement—by giving European-based U.S. foreign affiliates preferential market access and treatment to the east—has been hugely beneficial and profitable for U.S. multinationals. That said, however, Europe's periphery extends well beyond eastern and central Europe. It is much broader and dynamic.

Taking stock of Europe's extended periphery

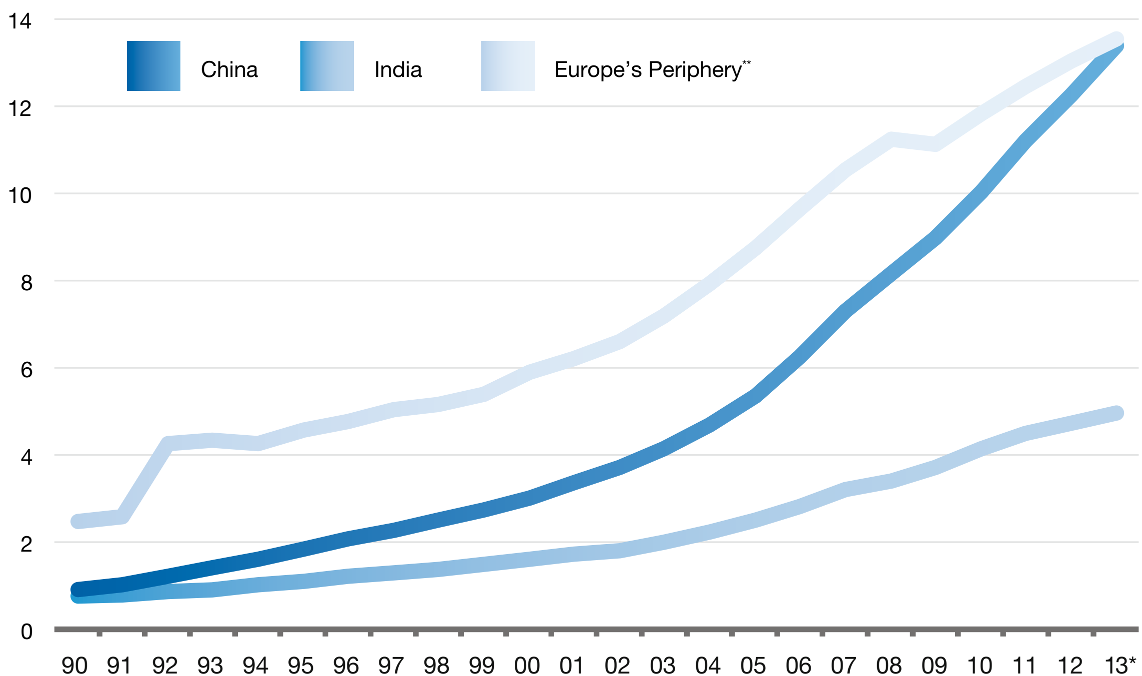
Europe's extended periphery—defined here as central and eastern Europe, including Russia; the Middle East, Turkey included; and Africa, notably North Africa—is unmatched on a global scale. While only two nations abut the United States, a dozen or so nations are considered a part of Europe's immediate neighborhood.

Granted, Europe's extended periphery contains many risks, which are frequently cited and rehearsed in the media. Less attention has been paid, however, to the fact that Europe's extended periphery represents one of the largest and most dynamic components of the global economy. And through formal and informal ties, Europe's trade, financial and investment linkages with this part of the world have deepened and thickened considerably over the past decade to the benefit of many U.S. firms operating in Europe.

For example, although Turkey remains outside the EU, that has not stopped bi-lateral trade from soaring over the past decade, with total EU-Turkey trade expanding 247% between 2000 and 2011. Total trade with Russia soared 561% over the same period; trade with Nigeria and its exploding middle class jumped 327% between 2000 and 2011. Europe-based U.S. affiliates have been a part of this surge in bi-lateral commerce, leveraging Europe as a springboard to the untapped and undeveloped markets surrounding mainstream Europe. In most cases, serving these distant markets from the United States is too costly; however, the costs and market opportunities vastly change when U.S. firms let their European affiliates take the lead. This strategy allows U.S. firms to be closer to their customers and competitors, lends itself to greater customization and localization by market, and promotes greater economies of scale, among other strategic advantages.

Europe's extended periphery is massive in size and scale. Indeed, the total output of this geographic cohort is slightly larger than China's total output. In 2013, the periphery nations produced $13.5 trillion in output versus China's $13.4 trillion (numbers are based on PPP). Relative to India, well, it's not even close, with India's output just 37% of Europe's periphery in 2013. China and India are home to more people than the periphery but the population of the latter is a great deal wealthier in most cases.

Out Producing Chindia: Output of Europe's Periphery versus China/India**
(Trillions of U.S. $)



**Estimate*

***Europe's Periphery: Developing Europe, Middle East, North Africa, and Sub-Saharan Africa*

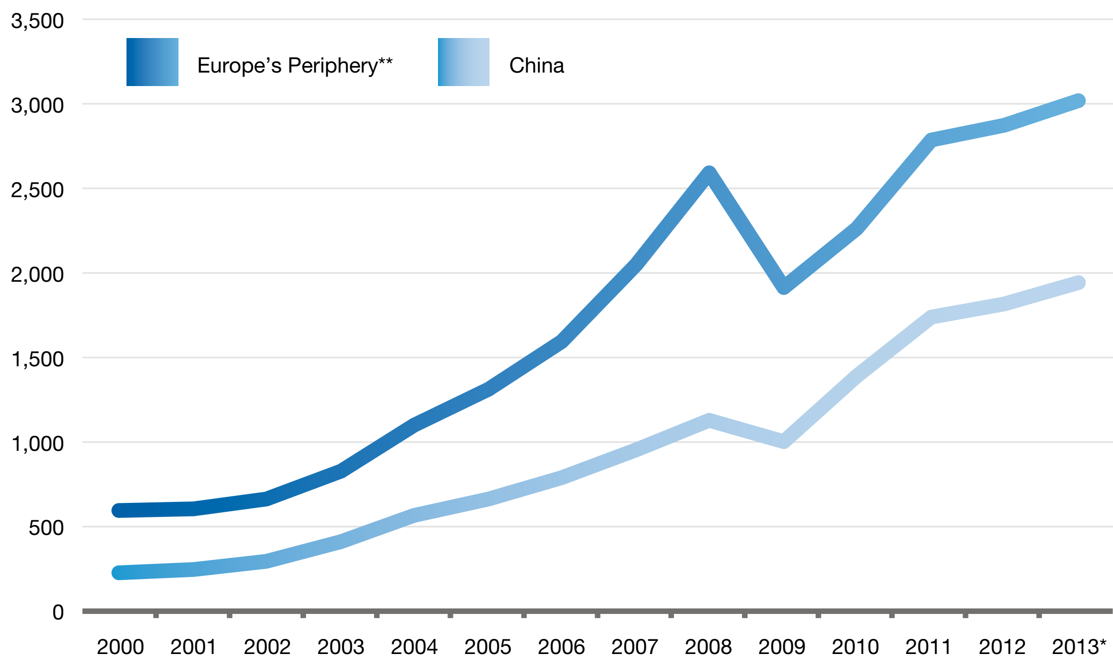
Source: International Monetary Fund

Parts of Europe's periphery are incredibly wealthy—think of the Middle East and the elevated per capita incomes of Saudi Arabia, Kuwait, and the United Arab Emirates. These nations are under-populated, although they punch above their weight when it comes to consuming western goods and services. On a per capita basis, the Middle East consumes more goods than virtually any place on Earth. Middle East imports totaled $914 billion in 2011, an oil-fueled rise in import demand of 342% from the levels of 2000.

Import demand in Africa has exploded at an even faster pace over the past decade. The region consumed roughly $500 billion in imports in 2011, a near five-fold increase from 2000. Thanks to soaring demand for primary commodities, and, in many cases, sharp improvements in the terms of trade, real economic growth of 5-6% or higher is becoming the norm in Africa. That suggests more consumption, and in fact, personal consumption expenditures in the Middle East/North Africa soared from $395 billion in 1995 to $1.4 trillion in 2011. In sub-Saharan Africa, consumer spending more than doubled, rising from $216 billion to $727 billion.

In the aggregate, Europe's periphery consumed an estimated $3 trillion in goods imports in 2013—a figure greater than imports of China and a figure larger than the world's top importer of goods, the United States. In various nations of Europe's periphery, demand for virtually everything—automobiles, capital machinery, luxury goods, consumer electronics, basic materials and other finished and unfinished goods—has simply soared over the last decade and more importantly, is expected to remain relatively robust over the next decade.

Who Needs China? Total Imports of Europe's Periphery versus the Middle Kingdom**
(Billions of U.S. $)



**Estimate*
***Europe's Periphery: Developing Europe, Middle East, North Africa, and Sub-Saharan Africa*

Source: International Monetary Fund

And the global winner in providing goods and services to the new consuming masses of Morocco, Jordan, Turkey, and Russia has been none other than the EU—due in large part to geography, historical trading ties, modern day financial linkages, and EU policies that have expanded and created various trade and investment channels with its periphery (e.g., the European Neighbourhood Policy program). The EU accounted for over 60% of central and eastern Europe's total imports in 2012. The EU was the top supplier to the Middle East/North Africa (with a 25% share in 2012), sub-Saharan Africa (24%), and to Russia and its partners in the Commonwealth of Independent States (35%).

In contrast, the U.S. share of imports were considerably lower to Europe's periphery but the figures mask the fact that many U.S. multinationals rely on their Europe-based affiliates to penetrate these markets.

U.S. firms "inside" the EU have been a part of the surge in trade between developed Europe and its extended periphery.

Looking forward, the outlook in Europe's periphery remains relatively positive. While real economic growth has slowed this year, Europe's periphery will handily expand at a pace much quicker than the Eurozone. The latter, according to the IMF, is expected to expand by 1% this year, underperforming expected growth in central and eastern Europe (2.8%), the Commonwealth of Independent States (2.6%), the Middle East and Africa (3.3%), and sub-Saharan Africa (6.1%). In many parts of the periphery, higher energy and commodity prices have generated huge surpluses, spurred investment, and boosted public spending.

Secular forces for growth remain quite strong and include the build out of infrastructure, an improvement in the terms of trade, and above all else, the emergence of a middle class numbering in the millions. Rising per capita incomes, the more prominent role of women, rising employment, higher wages—these and other factors will trigger another wave of global consumption right at Europe's door.

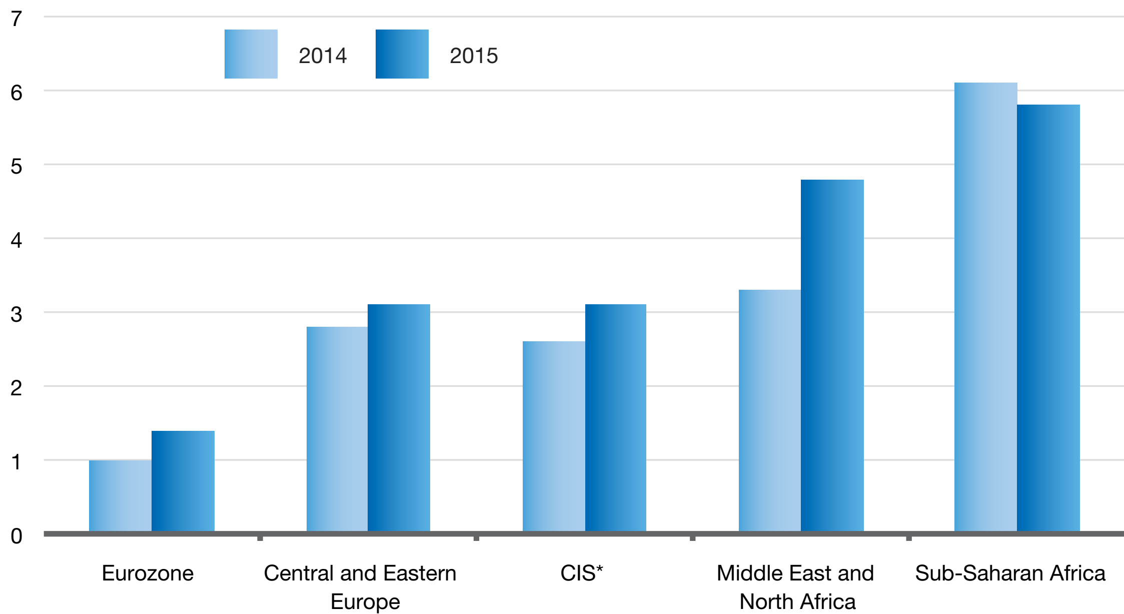
Developing Nations Key Suppliers: the European Union Stands Out
(Developing nations imports—% total from EU, U.S., and Japan)

Central/Eastern Europe		Middle East and North Africa		Sub-Saharan Africa		CIS*		Developing Asia		Latin America	
EU	**62.7%**	**EU**	**24.6%**	**EU**	**23.9%**	**EU**	**35.0%**	**EU**	**10.4%**	**EU**	**13.4%**
U.S.	2.9%	U.S.	7.9%	U.S.	6.4%	U.S.	4.2%	U.S.	6.8%	U.S.	31.3%
Japan	0.9%	Japan	3.6%	Japan	3.0%	Japan	3.5%	Japan	9.3%	Japan	3.4%

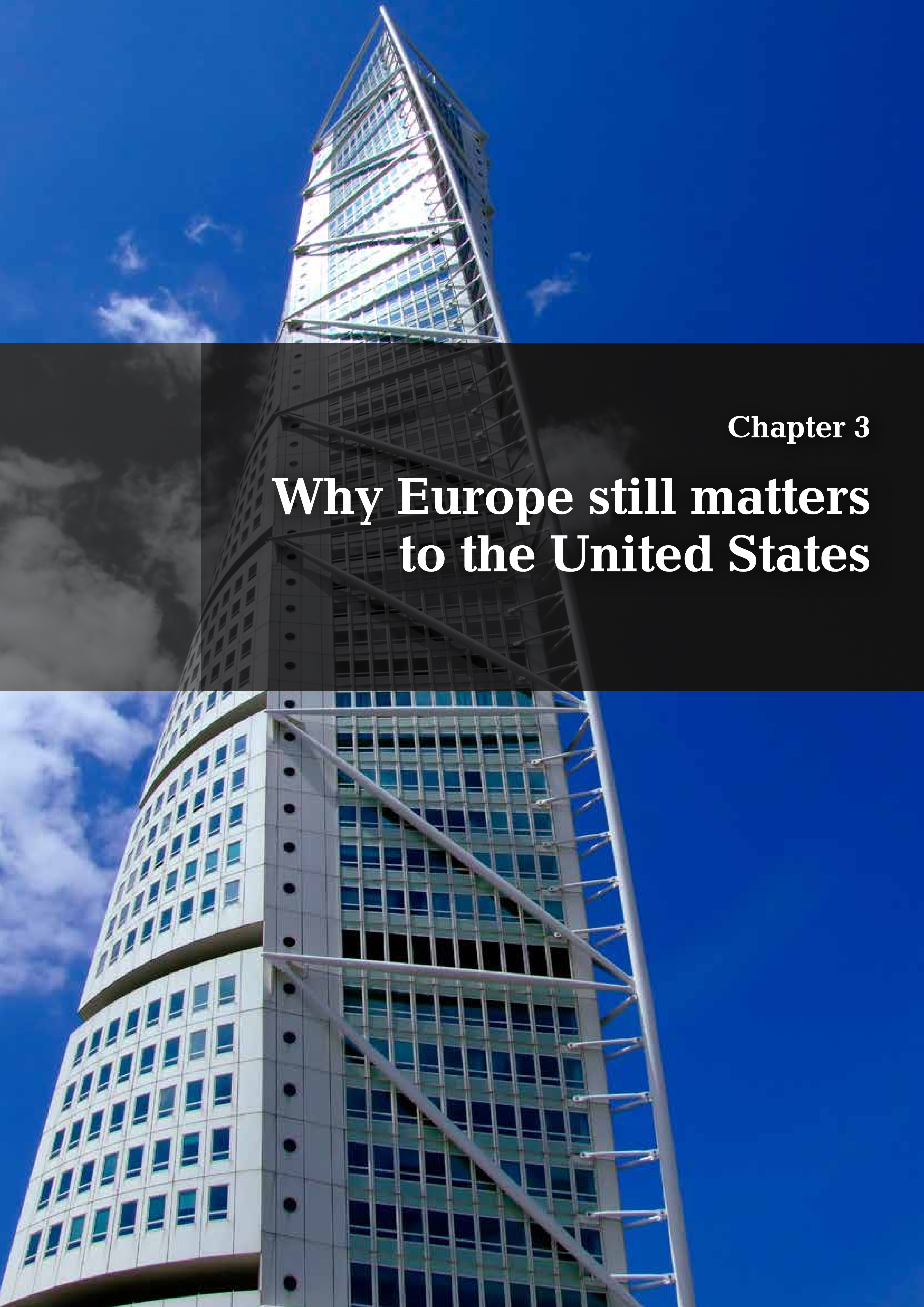
**CIS = Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Mongolia, Russia, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan*
Data for 2012 Source: International Monetary Fund

In the end, the EU's ties with developing nations—the world's new growth engine—are much deeper and thicker than either America's or Japan's. The EU's extended periphery is the sleeping giant of the global economy, but one that is finally ready to stir. In the decade ahead, there will be greater economic convergence between Europe and its periphery, with expanding trade and investment flows, along with the rising cross border flow of people, capital and ideas facilitating and enabling this convergence. All of this will transpire to the benefit of Europe and those U.S. firms with European operations.

Europe's Periphery to Lead the Way
(Real GDP growth, %)



**CIS = Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Mongolia, Russia, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan*
Source: International Monetary Fund



Chapter 3

Why Europe still matters to the United States

The preceding chapters outlined many of the things that are right with Europe, with many of the continent's attributes and endowments quite evident once one gets beyond the daily negative news flow. On a standalone basis, Europe is a formidable economic entity. The same is true on a relative or comparative basis.

When framing Europe's outsized role in the world economy, it is useful to think of the world economy as a four-engine Boeing 747. Engine One is North America, or the United States and Canada, accounting for just over one-fifth of world GDP based on purchasing power parity rates from the IMF. Engine One is also home to just 5% of the world population, but nevertheless accounts for nearly 30% of global consumption and nearly 16% of world imports. These figures are impressive but so are the figures for Engine Two—Europe.

Engine Two consists of the 28 member states of the EU and some smaller nations along Europe's eastern periphery. As made clear in previous pages, the EU and its periphery is one the largest economic entities in the world and among the wealthiest. This engine accounts for roughly 21% of world GDP and over one-quarter of global consumption. In terms of trade, Europe is not only the largest exporter in the world; it is also the largest importer. It is a top supplier of goods to the developing nations and is the largest trading partner of each BRIC nation—Brazil, Russia, India, and China. It is the largest provider and recipient of foreign direct investment among all world regions. These metrics underscore the fact Europe plays a key role in keeping the world economy aloft. Against this backdrop, it is little wonder then that when Engine Two sputters, the effects ripple around the world and place great strain on the world economy.

Because of malfunctions in Engine 2, global trade (goods and services) grew by just 2.7% in 2012 and by an estimated 2.9% in 2013, based on figures from the International Monetary Fund.

Engine Three is Asia, which has felt the pain of Europe's economic troubles via declining trade volumes and trade financing. Europe still matters—just ask thousands of Asian exporters whose orders and revenues have declined over the past year on account of the Eurozone crisis. China has been hit particularly hard by weak demand in Europe, with China's exports to the EU declining 6.2% in 2012 and by another 1% (estimated) in 2013.

The same ill effects have been quite apparent among the world's top commodity producers that make up the bulk of Engine Four. Their export receipts have softened with the Europe-led downturn in global demand, creating all sorts of problems and challenges for nations in Africa, South America, and Southeast Asia.

The Four Engines
(% of world total, 2012)

	Engine One: North America	Engine Two: Europe*	Engine Three: Asia	Engine Four: Commodity Producers
GDP (Purchasing Power Parity)	21.3	20.8	36.5	21.4
Population	5.0	8.6	55.8	30.6
Private Consumption Expenditure**	29.3	25.3	26.8	18.6
Exports	11.4	34.8	33.0	20.8
Imports	15.7	34.1	32.7	17.5
International Reserves***	2.0	13.2	57.8	27.1

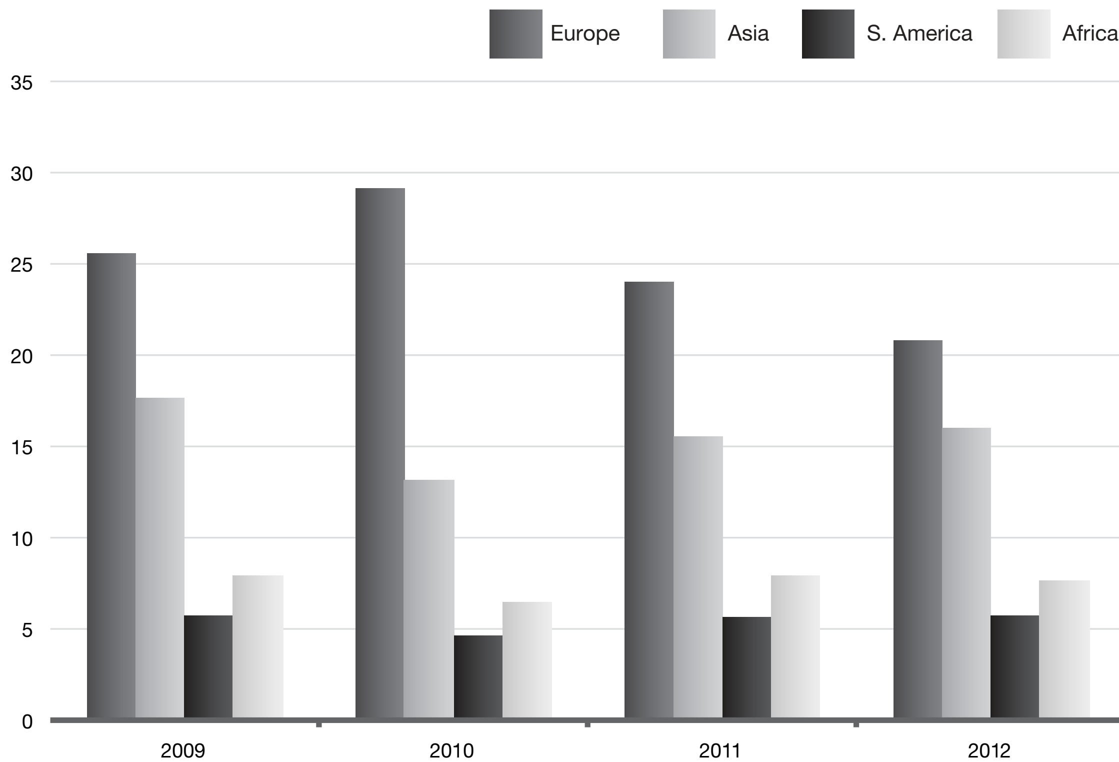
**Europe = EU28 plus Albania, Belarus, Bosnia and Herzegovina, Faero Islands, Iceland, Kosovo, Macedonia, Moldova, Montenegro, Norway, Serbia, Switzerland, and Ukraine*
***Personal or household consumption expenditure*
****Excluding gold*

Sources: International Monetary Fund, United Nations *Data as of January 2014*

Viewed from this lens, Europe, for many U.S. companies, is just too big, wealthy, and important to ignore. No serious American firm with global ambitions or in need of external markets for revenue and profits growth can forgo Europe.

This point is underscored by the following graph, which shows the foreign sales of firms in the S&P 500. Note the spread between foreign sales of Europe as a percentage of the foreign total (roughly 21% in 2012, the last year of available data) versus Asia (16% and South America (less than 6%). By a wide margin, in other words, Europe easily remains the most important foreign market in the world for corporate America.

This reflects not only the fact that Europe is one of most attractive markets in the world for business. It also reflects the massive bet corporate America has made on Europe over the past six decades, with no other region of the world attracting as much time and capital from U.S. firms. Since 2000, and on a cumulative basis, Europe has attracted roughly 56% of total U.S. foreign direct investment outflows.



This bet on Europe, in general, has paid handsome dividends over the past few decades. Indeed, the next chart highlights the fact that the transatlantic partnership has been beneficial for both parties, that when it comes to the bottom line—earnings—companies, including workers and shareholders, on both sides of the pond have prospered.

Note that between 1990 and 2000, what U.S. affiliates earned in Europe doubled from $33 billion to $66 billion. The creation of the Single Market in 1992 helped drive this process, as did underlying growth in Europe. Things only got better over the ensuing decade—indeed between 2001 and 2012, U.S. affiliate income (a proxy for global earnings) rose nearly four-fold, soaring from $54 billion in 2001, the year profits sank due to the transatlantic recession, to $214 billion in 2012.

In 2013, European affiliates of U.S. multinationals earned a record $230 billion (estimate), a figure some 3.5 times larger than the level of 2000 ($65.6 billion). Meanwhile, U.S. affiliates of European multinationals recorded a slight decline in earnings in 2013—estimated at $120 billion. Even with this modest annual decline, what European affiliates earned in the U.S. in 2013 was around three times greater than earnings in 2000.

Transatlantic profits—the long view

Not only did profits soar over this period, but the profits boom, recall, took place against the backdrop of heightened U.S.-EU acrimony over the U.S.-led war in Iraq, constant chatter about the two parties drifting apart, rapidly improving market prospects in China and the emerging markets, all culminating in the U.S.-led financial meltdown of 2008, which precipitated the worst global recession in decades and Europe's ensuing own financial crisis. Through it all—through thick and thin—the transatlantic partnership continued to yield significant benefits to companies on both sides of the Atlantic.

And these benefits, in general, have been spread far and wide. Rising U.S. foreign affiliate earnings in Europe, for instance, has underpinned more output and employment growth in Europe, more R&D expenditures across the continent, and more bi-lateral trade not only between the U.S. and EU but also between the EU and many other parts of the world. U.S. foreign affiliates in Europe have long been agents of growth in virtually every country that they have operated in. To the latter point, the gross output of American affiliates in Ireland now represents roughly one-quarter of the nation's gross domestic product, a staggering sum and presence of U.S. affiliates.

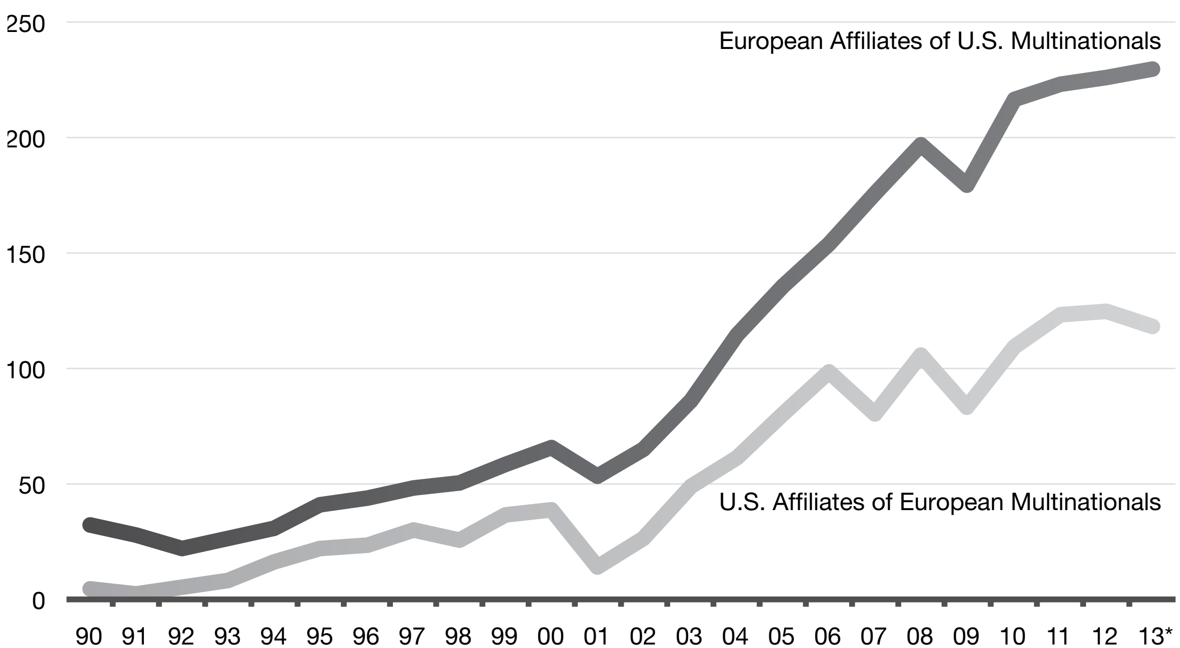
Meanwhile, the more profitable U.S. affiliates are in Europe, the more earnings are available to the parent firm to hire and invest at home, dole out higher wages to U.S. workers, and/or increase dividends to U.S. shareholders. In other words, U.S. corporate success in Europe is hugely important to the overall and long-term success of many U.S. multinationals, and by extension, to the U.S. economy. The more successful U.S. affiliates are in reaching new consumers in Europe and leveraging the continent's resources, the better off the foreign affiliate, the U.S. parent company, U.S. workers, shareholders, and local communities.

Being a part of Europe, or being "inside" the EU means being inside one of the largest economic entities in the world, and having the wherewithal to leverage Europe's competitive advantages, which can take the form of hiring life scientist in Ireland, conducting R&D with Swiss scientists, tapping the university talent of Grenoble, France, or participating in numerous government-sponsored R&D projects.

Another reason to be "inside" Europe is to avoid costs associated with various nations import tariffs and non-tariff barriers, all of which add to the cost of doing business and undermine U.S. competitiveness.

Finally, for many U.S. service providers, the very nature of their products—whether a financial service firm or a large-scale retailer—mandates that firms operate inside the EU. And given the potential of the massive market for various services in Europe, many U.S. firms are doing just that.

Transatlantic Profits—Affiliate Income
(Billions of U.S. $)



**Data through Q3 of 2013; 2013 data is annualized for full year estimate*

Source: Bureau of Economic Analysis *Data as of February 2014*

Services: The sleeping giant of Europe presents huge opportunities for U.S. companies

Services remain the great unexploited market in Europe, a sleeping giant that if unshackled could bestow tremendous cost benefits and profits on U.S. firms with pan-European operations.

The United States and Europe are the two leading services economies in the world. According to the World Trade Organization, the U.S. is the largest single country trader in services, while the EU is the largest trader in services among all world regions, accounting for 46.7% of global exports of services. Among the three largest components of global services trade—travel, transportation, and other commercial services—Europe ranks number one in each category.

Transatlantic services trade figures are impressive. But the more important services linkages are actually in mutual flows of foreign direct investment. The services economies of the U.S. and Europe have become even more intertwined over the past year, with cross-border trade in services and sales through affiliates posting strong gains. By sector, transatlantic linkages continue to deepen in financial services, insurance, education, telecommunications, utilities, advertising, and computer services. Other sectors such as aviation and e-health are slowly being liberalized and deregulated.

In terms of trade, Europe accounted for 38.1% of total U.S. services exports and for 41.6% of total U.S. services imports in 2012 (the last year of available data). Five out of the top ten export markets for U.S. services in 2012 were in Europe. The United Kingdom ranked 2nd, followed by Ireland (5th), Germany (7th), Switzerland (8th), and France (10th). Similarly, four of the countries just mentioned were among the top ten services providers to the U.S. The United Kingdom ranked first, followed by Germany (5th), Switzerland (6th), and France (9th).[1] The U.S. enjoyed a $66.8 billion trade surplus in services with Europe in 2012, compared with its $126 billion trade deficit in goods with Europe.

Thanks to a variety of factors—stronger growth, the weaker dollar, EU enlargement, industry reform and deregulation—U.S. services exports to Europe more than doubled between 2001 and 2012, rising from around $102 billion to $239 billion. U.S. services exports to Europe plunged by 9.4% in 2009 but rose 2.6% in 2010, 10.7% in 2011, and 3.8% in 2012, helped by rising exports (or receipts) of a number of services-related items like travel, passenger fares, royalties, and license fees. Gains were also reported among exports of “other private services”, or in such value-added activities as computer processing, engineering, advertising, and related activities. In this category, U.S. exports to Europe totaled $116 billion in 2012, yielding a near $30 billion trade surplus.

Beyond services trade, there are the foreign affiliate sales of services, or the delivery of transatlantic services by U.S. and European foreign affiliates. Sales of affiliates have exploded on both sides of the Atlantic over the past decade; indeed, affiliate sales of services have not only supplemented trade in services but have also become the overwhelming mode of delivery in a rather short period of time.

Sales of services of U.S. foreign affiliates in Europe in 2011 were more than two and a half times larger than sales in 2009, the year the transatlantic recession started.

That said, greater integration of transatlantic services would depend on future policies on both sides of the ocean. In Europe, national regulations in services are in need of greater harmonization, a process that would help remove significant barriers to entry for foreign firms. Many service standards or service professions in one nation are not recognized by another nation, a situation that keeps markets closed, incomplete, and less integrated. Another result—higher costs for consumers and businesses. The cost of broadband services, for instance, differs tremendously across the continent thanks to different regulatory regimes.

Due to the latter, digital services, such as Internet sales and IT support, are far less developed in Europe. For example, the U.S. accounts for around 80 percent of global e-book sales, but Europe for only 10 percent, mostly in the United Kingdom. In terms of the mobile wireless market, the U.S. and European markets have diverged, with the speed, traffic, voice minutes, intensity of smart phone use, and telecom investment, all greater in the United States than Europe. Greater convergence in the wireless space/usage could generate more growth on both sides of the transatlantic.

In many service activities, national regulations make it difficult for companies to operate Europe-wide, preventing efficiency and cost gains from being realized. Telecom services, biotechnologies, and pharmaceuticals are nationally regulated, leading to significant price divergence across Europe and reduced incentives for business to invest in R&D. In professional services, the mutual recognition of qualifications remains incomplete, while contract law and professional liability and insurance requirements differ and create risks for cross-border sales, particularly by small and medium enterprises.

Against this backdrop, services are among the last frontiers of Europe. Some estimate that the opening of services in the Single Market would add 4% to the EU's GDP.

That said, the liberalization of services and the deeper integration of services across the EU is expected to gather pace in the future, albeit slowly. Cross border trade and investment in services has been bolstered by falling communication and technology costs, and by the general recognition among policy makers that Europe's protected service activities are a key source of future growth. To the latter point, the European Commission passed the Services Directive in 2005 with the aim of reducing or eliminating regulatory barriers to services.

In the end, while the EU lacks a Single Market in services, various service activities in Europe are slowly but surely becoming unshackled and open to outside forces. There is plenty of upside to more seamless service activities within Europe and between the EU and the U.S., and with any luck, a transatlantic free trade agreement—the subject of the next chapter—could help drive this process.

1 Bureau of Economic Analysis, U.S. International Services, Cross-Border Services Exports and Imports by Type and Country.

Focus: GE

GE is one of Europe's leading industrial, advanced technology, services, and finance companies. For over 100 years it has been investing and growing across the region, where it employs 90,000 people. Europe remains a strategic market for GE, generating in excess of €23 billion in revenues (over 20% of global revenues) with assets of €149.8 billion. Europe is GE's largest single regional market outside the U.S. and is home to the headquarters of some of its global businesses including GE Oil and Gas, GE Healthcare, and GE Power and Water's gas engines business.

GE has a significant manufacturing presence in Europe with over 70 manufacturing sites located across 20 countries employing approximately 40,000 people devoted to R&D, engineering, and manufacturing. From here, the company exports to growth markets throughout the world. For example, GE's gas turbines, gas engines, and wind turbines manufactured in Europe provide 7% of the world's power.

GE recognizes Europe as an innovation hub. Over 30% of GE's global patents are filed from Europe while over one third of its healthcare R&D is undertaken here. GE has over 20 industry research centers focused on R&D across the continent, including a Global Research Center located near Munich, and has recently announced additional investments, including a €38 million investment by GE Healthcare in Hungary that will develop healthcare information systems.

Despite the challenging economic environment, GE remains committed to Europe and continues to make significant investments in the region. Europe has excellent infrastructure, very good healthcare and education systems, a highly skilled workforce, and a rich and diversified culture. GE leverages its European capabilities for the world by accessing systems for innovation and investment in Europe to grow globally. Of the €8 billion the company has invested in acquisitions over the past two years, €5.12 billion has been invested in Europe including the €3.3 billion acquisition of the Italian aviation company Avio, which employs 4,700 (4,000 in Italy in 2013). It is now the global center of excellence for GE for mechanical transmissions and low-pressure turbines. In 1994, GE acquired another Italian enterprise, Nuovo Pignone, which it has since built into a global player in oil and gas employing 4,500.

While GE clearly believes that the case for investing in Europe remains strong, it also believes that more can be done to improve the overall environment for investment. It strongly supports greater liberalization of trade and the ongoing dialogue on TTIP. The company also believes that the completion of the Single Market is an economic imperative and would make it easier to do business here and attract additional investment.

Chapter 4

TTIP— A potential global game changer

Ambitious, game-changing, a grand pact, transformational—rarely are U.S.-EU policy initiatives labeled or lauded as such, but the negotiations over what is known as the Transatlantic Trade and Investment Partnership (TTIP) could be all of the above and then some.

Such a deal would not only boost growth on both sides of the Atlantic. It could also potentially alter global trade flows in goods and services, reshape global production networks, and trigger a strategic rethink among multinationals if such a deal harmonized transatlantic rules and regulations, and eliminated inefficient and costly tariff and non-tariff barriers. TTIP would also strengthen the U.S.-EU economic axis relative to the developing nations and key emerging powers like China.

While a high degree of market integration already exists between the U.S. and Europe thanks to existing trade and investment agreements, much more can be done to fuse the world's two largest economies. A transatlantic free trade pact would not only be about reducing tariffs. It would also be about reducing non-tariff barriers and harmonizing the web of regulatory standards that inhibit transatlantic trade and investment flows and add to the cost of doing business on both sides of the ocean. A deal would be a win-win for both parties, with large transatlantic firms, as well as medium- and small-sized firms, reaping benefits.

The issues are more micro than macro. An ambitious agreement would include the harmonization of food safety standards, e-commerce protocols, and data privacy issues. It would also encompass the standardization of a myriad of service-related activities in such sectors as aviation, retail, architecture, engineering, finance, maritime, procurement rules and regulations, and telecommunications.

The move towards a more barrier-free transatlantic market would also include product standardization so that a car tested for safety in Bonn can be sold without further tests in Boston. Or a drug approved by the Federal Drug Administration in Washington is deemed safe and market-ready in Brussels. Labeling and packaging requirements on both sides of the pond would be standardized, saving companies millions of dollars over the long run. Reuters cites a German pharmaceutical executive as saying that when selling asthma inhalers in both the U.S. and Europe, the company had to spend $10 million just to prepare the product for the two markets because of the two different standards of dose counters.

Technical regulations and safety standards are hardly headlining grabbing topics but when these hurdles to doing business are stripped away, the end results are lower costs for companies, reduced prices for consumers and more aggregate demand of goods and services. That in turn spells more transatlantic trade and investment, as well as more jobs and incomes for U.S. and European constituents.

As for tariffs, average transatlantic tariffs are relatively low, in the 5-7% range, although tariffs remain quite high in such categories as agriculture, textiles and apparel, and footwear. So there is room for barriers to fall in a number of industries. More importantly, in that a large percentage of transatlantic trade is intra-firm, or trade in parts and components within a firm, even a small decline in tariffs—which are in effect a tax on production—can lower the cost of producing goods and result in lower prices for consumers on both sides of the Atlantic. The more intense the intra-industry trade component of trade between two parties, like the one that characterizes Irish-U.S. trade, the greater the effects and benefits of lower tariffs.

And in addition to trade in goods, there are services, with the transatlantic service economy the sleeping giant of the partnership. Unleashing service activities requires that existing regulatory rules and regulations be eliminated or reduced, which means doing away with "behind-the-border" barriers that include complex domestic regulations, cumbersome licensing and qualification requirements, and duplication of professional credentials, to name just a few barriers.

At a broad and macro level, a study by the European Commission found that eliminating or harmonizing half of all remaining tariffs and non-tariff barriers on bi-lateral trade would add significantly to growth over the medium term. Based off a study from the Centre for Economic Policy Research (CEPR), the Commission noted the following:

> *An ambitious and comprehensive TTIP could bring significant economic gains for the EU (€120 billion) and the U.S. (€95 billion), once the agreement is fully implemented and the economies fully adjust. These economic gains would represent a 0.5% and 0.4% increase in EU and U.S. GDP respectively by 2027 relative to their levels without the TTIP in place.*[1]

Annual Gains in GDP From a North Atlantic Free Trade Deal

	Bil. €	% of GDP
Less Ambitious		
European Union	68	0.3
United States	50	0.2
More Ambitious		
European Union	119	0.5
United States	95	0.4

Sources: UBS, "US-European free trade (TTIP): the implications."; CEPR.

The European Centre for International Political Economy, meanwhile, estimates that a deal could boost U.S. exports to the EU by 17% and EU exports to the U.S. by 18% over time.[2] The figures are not overly large but given the size of the U.S.-EU economies—combined, the U.S. and EU account for over half of world GDP—even a small percentage increase in trade or investment translates into a large increase in aggregate output.

A study by the Bertelsmann Stiftung, meanwhile, estimates that under an ambitious scenario, a total of 2 million additional jobs could be created by TTIP. Also, according to the study, real wages will rise, per capita incomes will increase, and trade growth will accelerate in most nations.[3] A study from the Atlantic Council suggests that "all fifty U.S. states are expected to increase net exports to Europe" under TTIP.[4]

In addition, given that both the U.S. and EU are dogged by massive debt obligations and chronic deficits, any growth strategy should have a net positive effect on the transatlantic economy. A free trade deal would help create jobs and income on both sides of the pond, and spur more cross-border trade and investment in goods and services. The more far-reaching the agreement, the greater the impact on key sectors of the transatlantic economy, notably in services where there is plenty of scope for further integration.

A U.S.-EU free trade agreement would do more than trigger economic activity. It would help reinvigorate a critical bi-lateral relationship that has been badly frayed and fractured over the past decade. Indeed, the last ten years have been among the rockiest in decades for the transatlantic partnership.

Transatlantic solidarity and cohesion has been undermined by the increasing frequency of economic recessions on both sides of the ocean. The U.S. dotcom bust and ensuing transatlantic recession in 2001, the U.S.-led financial crisis-cum-recession in 2008, and Europe's sovereign debt crisis of 2010—all of these economic shocks have taken a toll on U.S.-EU economic relations and eroded bi-lateral trust and cooperation.

Add in Europe's sovereign debt crisis, juxtaposed against robust economic growth emanating from China, India, and developing nations, and there is little wonder that many in Washington now believe Europe is increasingly irrelevant on the global stage. The rapidly aging, heavily indebted, and increasingly fragmented continent is viewed more of a withering partner of the United States than an engaging, forward-looking and dynamic ally. Hence the strategic "pivot" towards Asia.

But enter the prospects for a free trade agreement. Such a deal—if comprehensive and far-reaching—could be just the spark that re-galvanizes a bi-lateral partnership responsible for constructing and maintaining the global economic order of the post-war era. A free trade agreement could halt the divergence of interests between the U.S. and Europe, and spawn a new dawn of cooperation and convergence between the world's two largest economies.

Under this scenario, the transatlantic economy, the largest commercial artery in the world, would be revived. The global clout and credibility of the United States and Europe would be restored. By coming together as opposed to drifting apart, the U.S. and Europe would remain the standard bearers of the global economic architecture. Whatever the common standards of a free trade agreement, and whatever the harmonization and standardization of industry/sector regulations, a transatlantic deal could become the template by which the United States and Europe negotiate with various emerging market economies, China included.

In this sense, a transatlantic free trade agreement would serve notice to the developing nations that the world's two largest economies can still work together, and when they do, they still have a great deal of global economic leverage over most, if not all, developing nations.

Comparing FTAs
(Billions of U.S. $ unless otherwise specified)

	Trans-Atlantic FTA	Trans-Pacific FTA	North American FTA
GDP (Purchasing Power Parity)	15,993	10,755	3,272
% of World Total	19.2%	12.9%	3.9%
Population (thousands)	508,381	483,649	155,685
% of World Total	7.2%	6.8%	2.2%
Per Capita Income ($)	32,797	24,587	19,262
PCE	9,720	7,066	1,815
% of World Total	23.2%	16.9%	4.3%
Exports	5,583	2,801	824
% of World Total	31.3%	15.7%	4.6%
Imports	5,734	2,934	917
% of World Total	31.1%	15.9%	5.0%
U.S. Outward FDI Stock to…	2,238	934	452
% of U.S. Total	50.3%	21.0%	10.2%
U.S. Inward FDI Stock from…	1,642	620	240
% of U.S. Total	61.9%	23.4%	9.1%
U.S. FDI Income Earned Abroad	196	96	44
% of U.S. Total	43.6%	21.4%	9.8%
Foreign FDI Income Earned in the U.S.	107	37	16
% of U.S. Total	70.9%	24.6%	10.3%
Foreign Affiliate Sales of U.S. MNC's in…*	2,375	1,852	871
% of U.S. Total	39.8%	31.0%	14.6%
U.S. Affiliate Sales of Foreign MNC's from…*	1,857	909	267
% of U.S. Total	52.9%	25.9%	7.6%

**Data for 2011*

Sources: IMF; UN; and BEA   Data for 2012

But whether or not the U.S. and Europe can pull off such a deal remains in question. Not unexpectedly, there is resistance on both sides to certain parts of TTIP that could delay or scupper the deal outright. Key hurdles revolve around the following: agricultural trade, food safety regulations, the use of Big Data and privacy issues, financial regulations, public procurement spending, air and maritime rights, and more. Another key hurdle: upcoming elections in the European Parliament, whose incoming members could add some political resistance to TTIP and the fact that President Obama has yet to gain Trade Promotion Authority from Congress; the latter is going to be required to turn any trade deal into trade law.

In the end, a sweeping free trade agreement between the United States and the European Union would be a global game-changer. The deal would reverberate around the world. And in time, Washington and Brussels would come to realize that the best way to promote and rise to the challenge of emerging powers like China is by working together, not apart.

1 "Transatlantic Trade and Investment Partnership, the Economic Analysis Explained," European Commission, September 2013.
2 "Transatlantic Task Force on Trade, Ideas for New Transatlantic Initiatives on Trade," European Centre for International Political Economy.
3 "Transatlantic Trade and Investment Partnership (TTIP) Who Benefits from a free trade deal?" Global Economic Dynamics, Bertelsmann Stiftung, 2013
4 "TTIP and the Fifty States: Jobs and Growth from Coast to Coast" The Atlantic Council of the United States, 2013

Focus: Ford

Ford of Europe is the number two best-selling automotive brand in Europe, selling over 1.35 million vehicles across its total European region in 2013. Almost 100% of Ford vehicles sold in Europe are made in Europe, and the number of Ford vehicle exports from Europe to other parts of the world exceeds the number of Ford vehicles imported into Europe.

Ford shipped its first car to Europe in 1903, the same year that Ford Motor Company was founded in the United States, and European production of Ford vehicles started in 1911. Today, Ford is building a lean and efficient business ready to take on the challenges and opportunities for the next century 100 years in Europe.

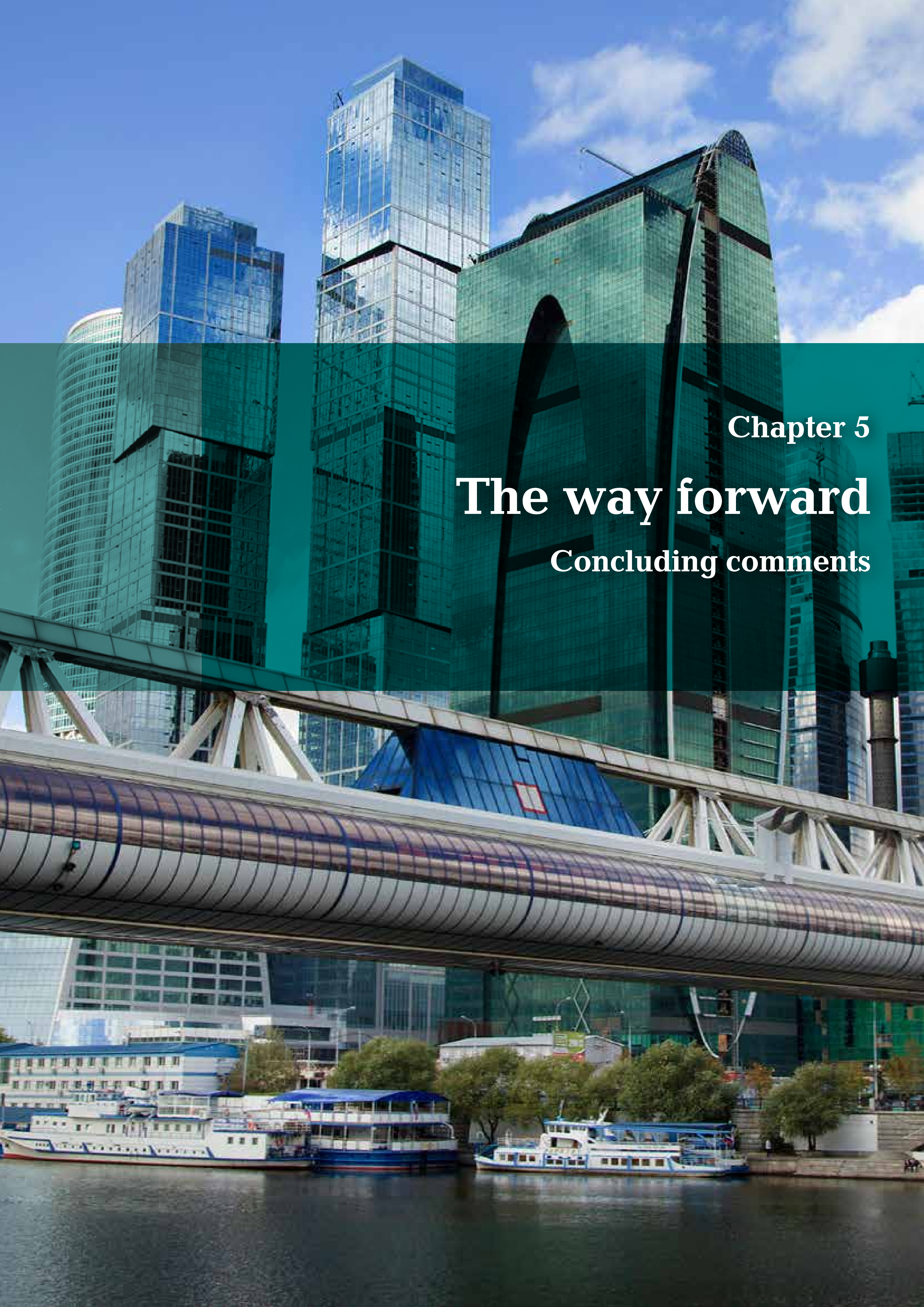
Ford of Europe, headquartered in Cologne, Germany, is responsible for designing, engineering, manufacturing, selling, and servicing Ford brand vehicles in 50 individual markets. Ford employs around 47,000 people at its wholly owned facilities in Europe, and approximately 67,000 people when joint ventures and unconsolidated businesses are included.

In addition to Ford Motor Credit Company, Ford of Europe operations also include Ford Customer Service Division and 22 manufacturing facilities (13 wholly-owned or consolidated joint venture facilities and nine unconsolidated joint venture facilities). These manufacturing sites are located in the UK, Germany, Spain, Romania, Belgium, and France.

Europe is critical to Ford's global growth targets. It is a key sales market and also of strategic importance in the global product development process. Ford of Europe's product development team leads the development of B and C segment cars, such as the Ford Fiesta and Ford Focus, plus Ford's diesel engines and small petrol engines, and the highly successful Ford Transit commercial vehicle.

This year alone, Ford will launch 10 new vehicles in Europe—part of a plan to launch at least 25 new global vehicles in Europe in the five years from October 2012. Ford will continue to build on the great progress made last year on its private customer, fleet and commercial vehicle shares.

Ford is also continuing to transform the customer experience with new-look dealerships and improved online portals, plus the launch of Vignale next year, a unique product and tailored ownership experience that drives the Ford brand in Europe into a more upmarket segment. Ford will also complete the right-sizing of its manufacturing footprint in Europe by the end of 2014, resulting in an 18% improvement in the capacity utilization of its manufacturing plants in Europe at an annual savings of $450-$500 million.



Chapter 5

The way forward

Concluding comments

On the 100-year anniversary of World War I, it is worth recalling why the Norwegian Noble Committee awarded the 2012 Nobel Peace Prize to the EU.

As the Committee noted:

> *The EU is currently undergoing grave economic difficulties and considerable social unrest. The Norwegian Nobel Committee wishes to focus on what it sees as the EU's most important result: the successful struggle for peace and reconciliation and for democracy and human rights. The stabilizing part played by the EU has helped to transform most of Europe from a continent of war to a continent of peace.*

Europe is a continent of success—notwithstanding the past four years of economic difficulties and reawakened Cold War tensions in Ukraine. The post-war economic integration of the EU is one the greatest triumphs of the past sixty years. It ranks right up there with the rise of China over the past three decades. At the core of Europe's peace and reconciliation is the fact that no other region of the world has successfully integrated and grown as a single entity like the EU. Over the post-war era, Europe has not only made itself economically stronger, it has also made the world economy stronger and safer. And a primary beneficiary of this dynamic has been Europe's long-time strategic partner—the United States.

The previous chapters have highlighted what's right with Europe amid all the doom and gloom over what is wrong with America's key transatlantic partner. This report serves as a critical and timely reminder that given all the challenges before the continent today, Europe still remains among the most attractive long-term places in the world for business.

Indeed, the case for Europe rests on many building blocks. First, the Eurozone not only remains intact but in time will also include other member states. In 2014, Latvia became the 18th state to join the currency union, following in the footsteps of Estonia (2011), Slovakia (2009), Malta (2008), Cyprus (2008), and Slovenia (2007). The Eurozone started with 11 members in 1999, but has since seen its membership rise 63%. Second, thanks to more pro-growth policies and aggressive measures by the ECB, Europe has emerged from recession and is expected to grow by 1-2% this year. A proactive ECB and monetary reflation, a weaker euro, a rebound in external demand, and continued economic strength among the northern states will assist in expansion in 2014/15. Third, long-term structural reforms will continue, with Europe's sovereign debt crisis a catalyst for public sector reform, pension reform, labor market reform, and the deregulation of many service activities. Gradually, Europe has moved closer towards creating a banking union. Fourth, the institutional framework of the Eurozone has become stronger and more effective in the management of Eurozone issues. And finally, membership in the EU will continue to expand over the balance of this decade, as more of Europe's periphery formally joins the Union.

Add in the prospects of transatlantic free trade agreement, and the case for staying the course in Europe becomes even more compelling.

In a world prone to boom and bust, we have come to learn that just as it takes time to accumulate a mountain of debt, so it takes time to deleverage or unwind debt levels well in excess of historic levels. In other words, the scars of a debt-fueled boom and bust are deep and long lasting, but as other financial crises have shown, the wounds eventually heal.

Europe has been no different. The healing process continues, but Europe is healing and is on the mend. Granted, the region is in for some trying times ahead. Future headlines will speak about more debt restructuring, mounting political pressure, structural high unemployment rates, and wealth transfers between rich and poor. The list goes on. This will be a multi-year process with each pressure point testing the will and solidarity of Europe. Yet in the end, vested interests—inside and outside of Europe—will hold the core and periphery together, as will a general populace supportive of a united Europe.

Post-crisis Europe will remain one of the largest and wealthiest markets in the world for the foreseeable future. U.S. firms that require global scope, external resources, and growth markets outside the United States can ill afford to ignore or pass on Europe's wealthy consumer base, skilled labor pool, technology and innovative clusters, and proximity to many dynamic emerging markets.

Meanwhile, at a time when America's work force is aging and shrinking, U.S. firms need even greater access to Europe's labor market. American firms presently confront a skilled labor shortage, alleviated, to a degree, by access to Europe's skilled labor pool.

By the same token, at a time when R&D has gone global, U.S. innovative leaders are increasingly looking to Europe as a partner/collaborator for new technology and innovation, as well as a critical source of R&D funding. Also, with trade and investment protectionism gaining traction in many key emerging markets—think Brazil, India, and China—corporate America's unfettered access to Europe's massive market is even more imperative and important. And speaking of the emerging markets, Europe's periphery, despite near-term cyclical challenges, has emerged as one of the most promising components of the global economy, with U.S. firms "inside" Europe well positioned to leverage Europe as a springboard to these burgeoning markets.

All of the above underscores the continued and long-term importance of Europe to the bottom line of corporate America. It is Europe's wealthy consumer market, a transparent rule of law, a liberal investment climate, and a large pool of skilled labor that sets the region apart from the emerging markets and makes Europe corporate America's profit center.

In the end, notwithstanding Europe's past weaknesses, troubles on account of the sovereign debt crisis, and geo-political tensions in Ukraine, the region's fundamentals and underlying attributes remain solid. The case for investing in Europe—and the justification for U.S. companies staying the course—remains very much intact.

About the author

Joseph Quinlan is a leading expert on the transatlantic economy and a well known economist/strategist on Wall Street. He specializes in global capital flows, foreign direct investment, international trade, and multinational strategies.

Mr. Quinlan lectures on finance and global economics at New York University and Fordham University. In 1998, he was nominated as an Eisenhower Fellow. Presently, he is a Senior Fellow at the Center for Transatlantic Relations and a Fellow at the German Marshall Fund. He served as a Bosch Fellow at the Transatlantic Academy in 2011.

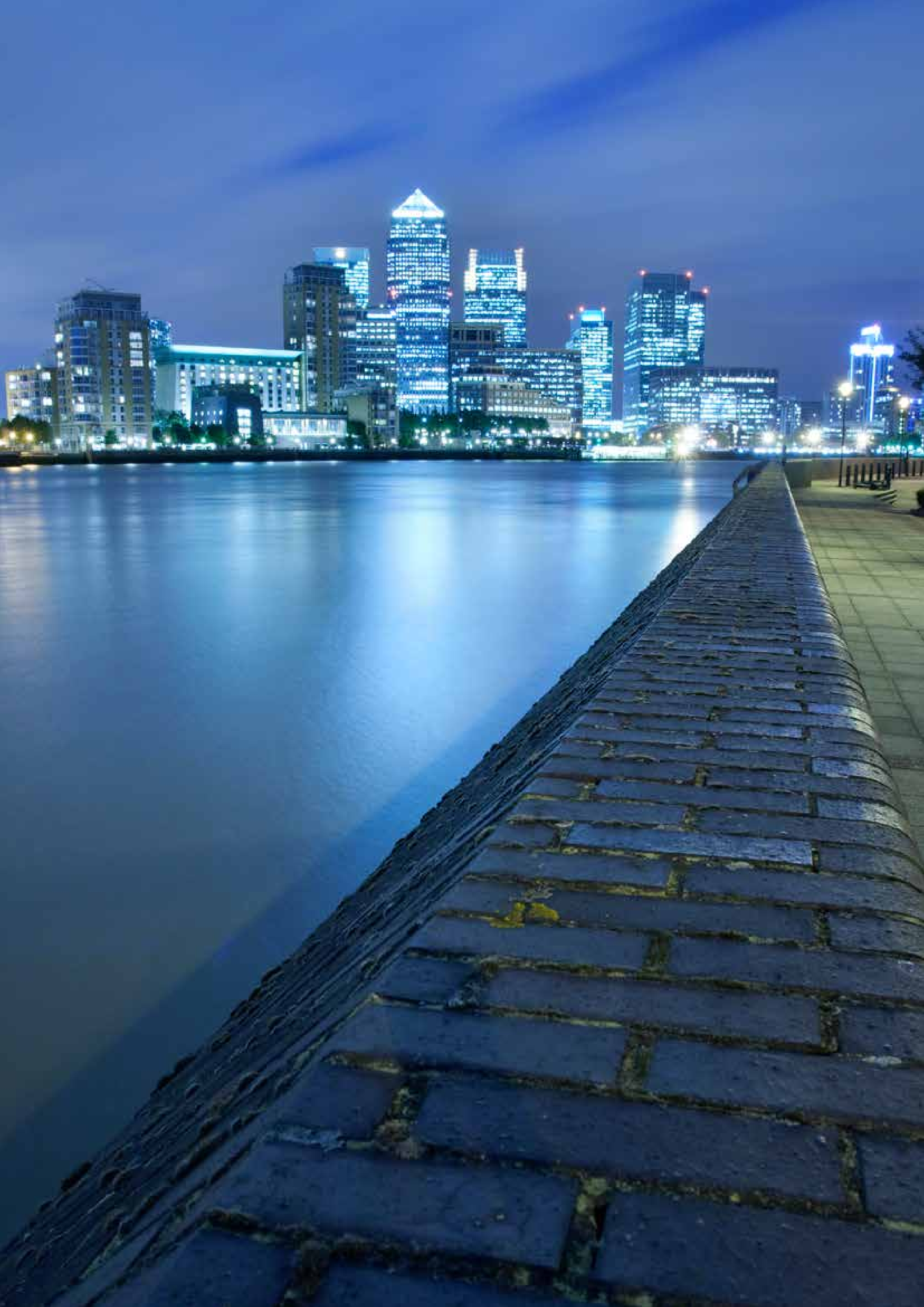
In 2006, the American Chamber of Commerce to the European Union awarded Mr. Quinlan the 2006 Transatlantic Business Award for his research on U.S.-Europe economic ties. In 2007, he was a recipient of the European-American Business Council Leadership award for his research on the transatlantic partnership and global economy.

Mr. Quinlan regularly debriefs policy makers and legislators on Capitol Hill on global trade and economic issues. He has testified before the European Parliament. He has served as a consultant to the U.S. Department of State and presently serves as the U.S. representative (Economic Policy Committee) to the Organisation for Economic Co-operation and Development in Paris, France for the U.S. Council for International Business. He is also a board member of Fordham University's Graduate School of Arts and Science and serves on Fordham University's President Council.

He is the author, co-author, or contributor to twenty books. His most recent book, "The Last Economic Superpower: The Retreat of Globalization, the End of American Dominance, and What We Can Do About It" was released by McGraw Hill in November 2010. He has published more than 125 articles on economics, trade and finance that have appeared in such venues as Foreign Affairs, the Financial Times, The Wall Street Journal and Barron's. He regularly appears on CNBC, as well as Bloomberg television, PBS and other media venues.

About AmChams in Europe

Founded in 1963, AmChams in Europe (the European Council of American Chambers of Commerce) is a network of American Chambers of Commerce across Europe. Its mission is to exchange best practice ideas, mutual member company benefits and to provide a forum for discussion, debate and where necessary representation on issues relevant to the European business environment. AmChams in Europe's member companies account for more than $1.1 trillion in investment on both sides of the Atlantic.



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AmChams in Europe
(European Council of American Chambers of Commerce)
c/o AmCham EU
Avenue des Arts 53
B-1000 Brussels
Belgium

T (32 2) 289 10 14
E ecacc@amchameu.eu
www.amchamsineurope.com