The Case for Investing in Europe 2013

Why U.S. firms should stay the course

Joseph P. Quinlan

AmChams in Europe

Preface and Acknowledgements

Despite the current bad press about the region, the case for investing in Europe remains as strong as it has ever been. A longer view shows that the future will be no different.

Even though the ascendency of China and the BRICs is at the forefront of public consciousness, Europe will remain one of the largest and wealthiest economic entities in the world for the foreseeable future. As such, American companies that wish to have a truly global reach cannot afford to ignore what Europe has to offer: a wealthy consumer base, a skilled labor force, and well-developed technological and innovative clusters. With all of its parts combined, the European economy is larger than the American economy; something that must be considered by American companies wanting a global presence.

The value of Europe lays not only its economy, but also in its periphery. Europe's neighborhood—which includes Russia in the North, Turkey to the east, the Middle East and North Africa to the south and west—represents one of the most dynamic areas of the global economy. 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 U.S. 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 U.S. shareholders.

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What's right with Europe

The aggregate output of the European Union was estimated at $16.1 trillion in 2012 (PPP). The EU's economy is roughly 30% larger than China's and nearly 3.5 times larger than India's.

Europe is not only among the largest economic entities in the world, it is also among the wealthiest. In 2012, the EU accounted for roughly one quarter of global personal consumption expenditures, on par with the United States and around two-thirds larger than the BRIC's combined.

In the 2013 Ease of Doing Business rankings, 12 European economies ranked in the top 25 most business-friendly nations. Denmark ranked 5th, followed by Norway (6th), the UK (7th), Georgia (9th), Finland (11th), Sweden (13th), Iceland (14th), Ireland (15th), Germany (20th), Estonia (21st), Macedonia (23rd), and Latvia (25th).

Many European economies remain among the most competitive in the world. According to the World Economic Forum, Switzerland ranked first, Finland 3rd, Sweden 4th, the Netherlands 5th, Germany 6th, and the UK 8th. Meanwhile, Denmark ranked 12th, Norway 15th, Austria 16th, Belgium 17th, France 21st and Luxembourg 22nd.

Europe-based companies accounted for roughly 25% of total global R&D in 2010 and 2011. That lagged the share of the United States (32% in 2011) but was well ahead of the global share of R&D spending in Japan (11.4%), China (13.1%), and India (2.8%).

According to the National Science Board, of the world's global research pool, the EU housed 1.5 million researchers in 2008 versus 1.4 million in the United States. The EU accounted for 25% of the global total.

Why Europe still matters

For firms in the S&P 500, foreign sales in Europe (24% in 2011, the last year of available data) were greater than Asia (15.5%) and South America (less than 6%).

Between 2001 and 2012, U.S. affiliate income rose nearly four-fold, soaring from $54 billion in 2001, the year profits sank due to the transatlantic recession, to $214 billion last year.

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 bilateral 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 have operated in. For example, the gross output of American affiliates in Ireland represented roughly one-quarter of the nation's gross domestic product in 2011.

The China next door

More than 12% 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 1999-2009 versus a comparable 0.8% rate in western Europe.

Consumerism—as measured by personal consumption expenditures—in central and eastern Europe has soared over the past decade—doubling between 1990 and 2005 and then nearly doubling again by 2011, when expenditures totaled $2.6 trillion.

Total EU-Turkey trade expanded 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. European-based U.S. affiliates have been a part of this surge, leveraging Europe as a springboard to the markets surrounding mainstream Europe.

Europe's extended periphery is massive in size and scale. Indeed, the total output of this geographic cohort is larger than China's total output. In 2012, the periphery nations produced $13.2 trillion in output versus China's $12.4 trillion (numbers are based on PPP).

In the aggregate, Europe's periphery consumed a staggering $2.8 trillion in goods imports in 2011—that is 60% larger than total imports of China and a figure larger than the world's top importer of goods, the United States.

A U.S.-EU free trade agreement: a potential global game changer

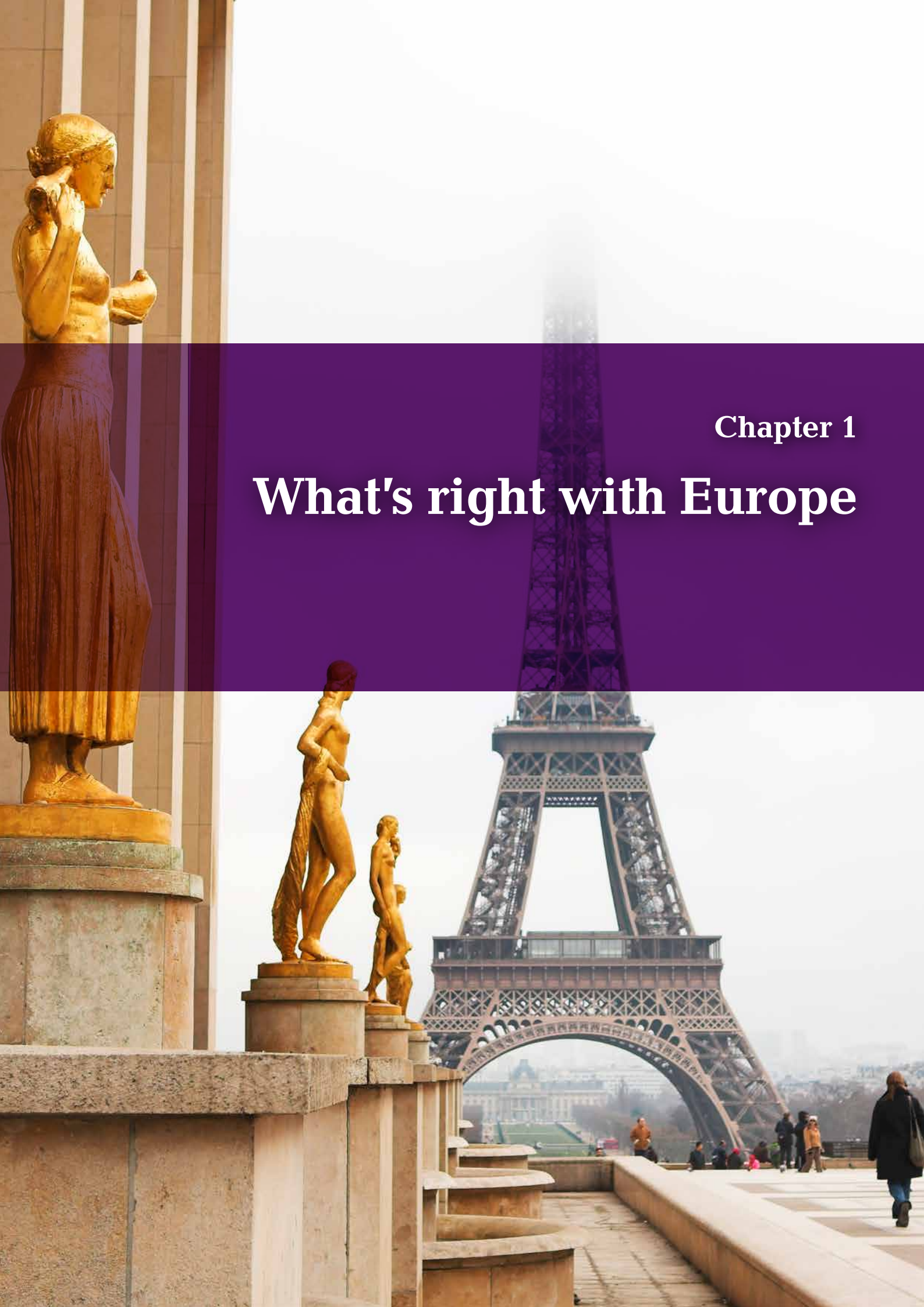
Momentum is building for a new and comprehensive free trade agreement between the United States and the EU. Such a deal would not only boost growth on both sides of the Atlantic. It would also strengthen the U.S.-EU economic axis relative to the developing nations and key emerging powers like China.

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.

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 trade, architecture, engineering, finance, maritime, procurement rules and regulations, and telecommunications.

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

Whatever the common standards and the harmonization and standardization of industry/sector regulations, a transatlantic deal could become the template by which the U.S. and Europe negotiate with various emerging market economies, China included.



Chapter 1

What's right with Europe

Yes, there is plenty wrong with Europe. But there is more to Europe than the current tidal wave of negativity washing over the continent. On a fundamental basis, there is plenty right with Europe as well, giving plenty of reasons for U.S. firms to stay the course in Europe.

There is nothing more fashionable these days than being negative or "bearish" on Europe, and for good reason. Europe is clearly the "Sick Man" of the global economy, battered by a protracted economic downturn and a financial crisis that has raged on for the past four years. Presently, not one but two Eurozone economies are in the grips of a Depression-like contraction in output—Greece and Cyprus. Other nations are in recession or stuck in stagnation. Unemployment across the continent is at record highs; Europe's level of youth unemployment (measured as 15 to 24 years of age) is simply staggering, with one in four youths in Europe in search of work. In Spain, the rate is above 55%. In Greece, it is closer to 60%.

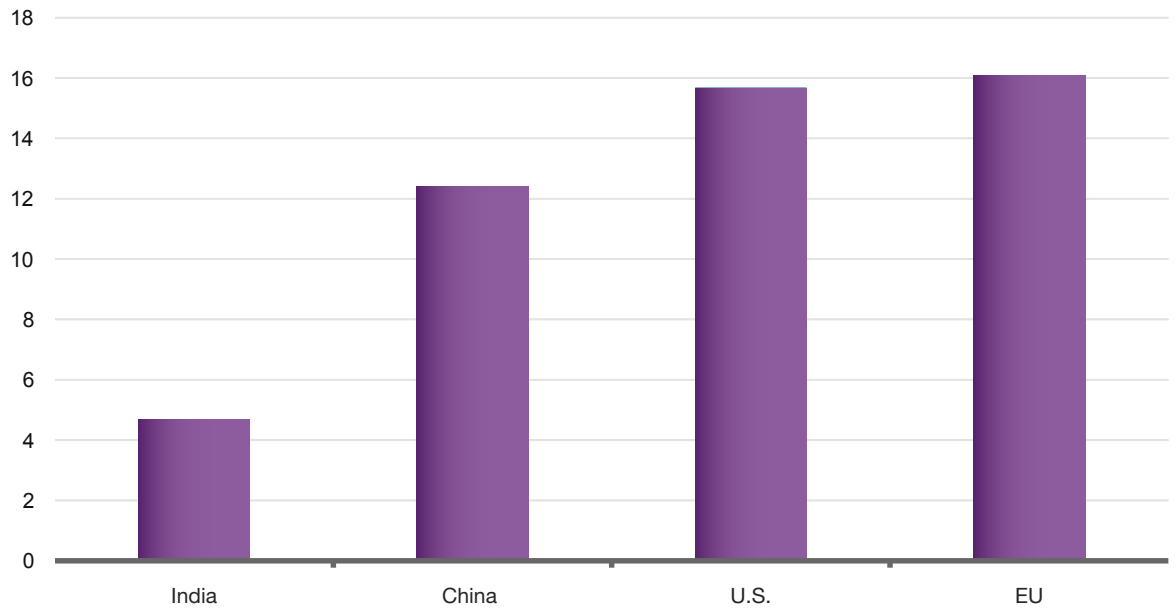
Plant closures, undercapitalized banks, massive debt loads, uncompetitive economies and industries—the litany of woes and challenges before the continent are herculean. Make no mistake about it, Europe's leaders and citizens confront one of the greatest challenges of the post-war era.

While the post-crisis landscape remains far from clear, there has been progress in safeguarding against the next crisis coupled with a further deepening the integration of the continent. Some heavy lifting has taken place over the past few years: the role of the European Central Bank, for instance, has been significantly enhanced in the crisis; more crisis resolution tools are in now in place; the outlines of a banking union have taken shape, but admittedly, need more work; the competitiveness and economic adjustments of the peripheral nations, while incomplete, has improved; and the first moves towards a fiscal union have been taken, involving greater fiscal convergence and surveillance, among other policies. All of the above, to be sure, are small steps—but positive steps forward nevertheless.

First, even allowing for the last four years of sluggish real growth, the European Union remains the largest economic entity 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 some cases, by embracing these and other strategies over the past few decades—the sum of Europe's parts are unparalleled and greater than any other competing economic entity in the world.

No American firm can afford to ignore a market that was roughly 5% larger than America's in 2011, the last year of full year data. 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 27 Member States, with more states waiting to join. Croatia joins the club in 2013.

EU GDP 2012 vs. the US, China and India
(% of global total, GDP based on purchasing-power-parity)



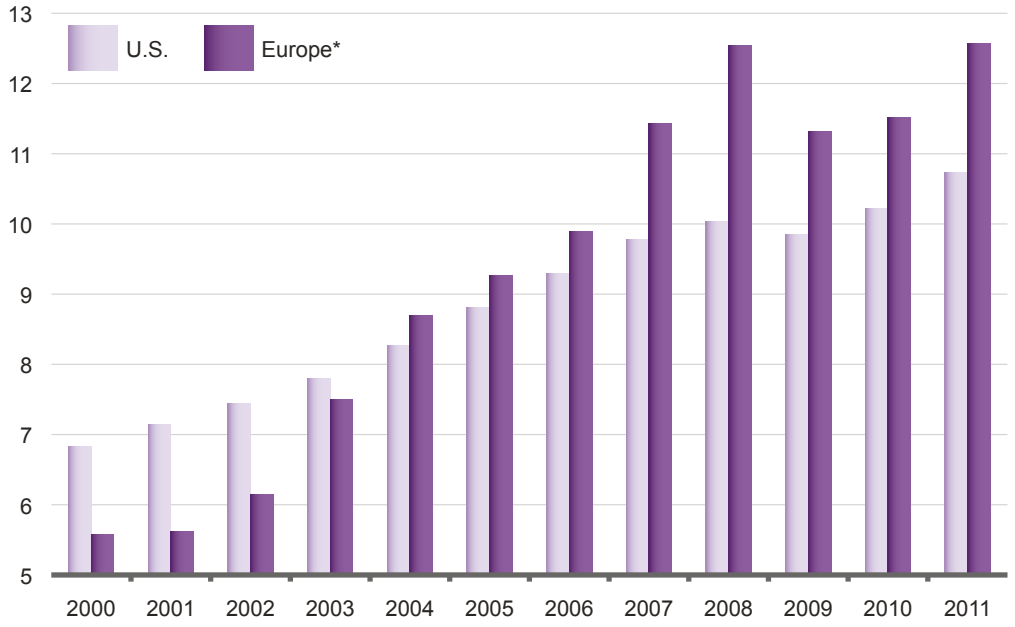
Source: International Monetary Fund *Data for 2012*

The aggregate output of the European Union was estimated at roughly $16.1 trillion in 2012 (based on a purchasing power parity [PPP] basis). To put that figure into perspective, the EU's economy is roughly 30% larger than China's and nearly 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.

Europe is not only among the largest economic entities in the world, it is also among the wealthiest. In 2012, the European Union accounted for roughly one quarter of global personal consumption expenditures, a share on par with the United States and a share around two-thirds larger than the BRIC's combined. 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 $)

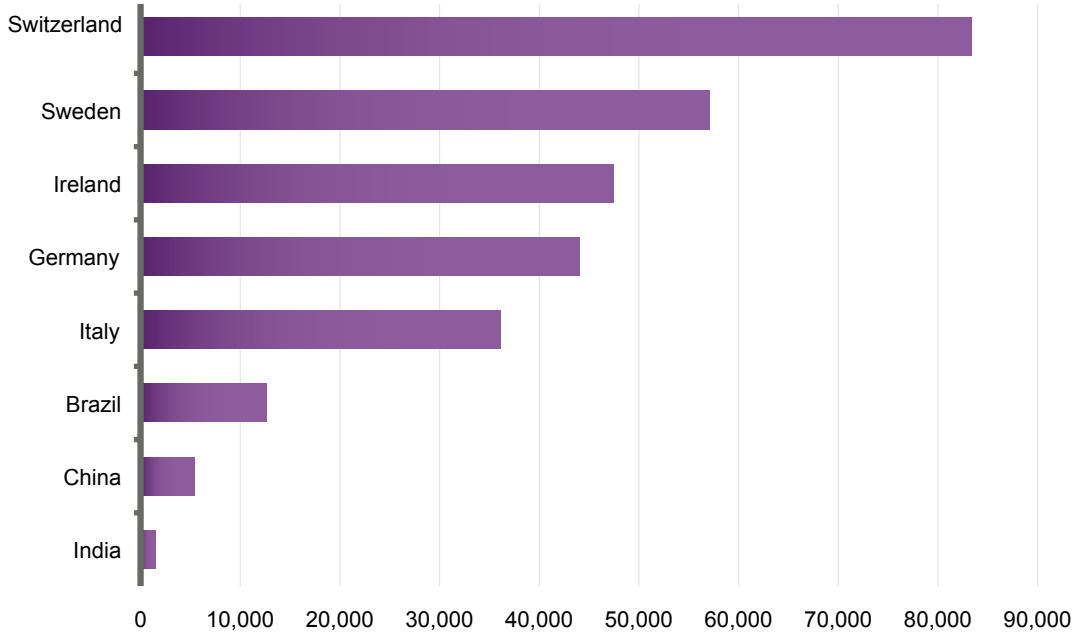


Europe=EU27 plus Norway, Switzerland, Iceland, Albania, Bosnia and Herzegovina, Croatia, Macedonia, Montenegro, Serbia, Turkey, Armenia, Azerbaijan, Belarus, Georgia, Moldova Russia, and Ukraine.

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 $5,448 in 2011, according to figures from the World Bank. The figure ranks 86th in the world and is well below the per capita income levels of Sweden ($57,091), the Netherlands ($50,076), Ireland ($48,423), Germany ($44,060), and the European Union average of $34,892 in 2011. With a miserly per capita income of $1,488, India ranks 136th.

The Wealth of Nations
(GDP per capita, $)



Source: World Bank Data for 2011

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.

However, micro factors matter as well. 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 enforcement, 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 Europe 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 rankings, 12 European economies ranked in the top 25 most business-friendly nations. Denmark ranked 5th overall, followed by Norway (6th), the United Kingdom (7th), Georgia (9th), Finland (11th), Sweden (13th), Iceland (14th), Ireland (15), Germany (20th), Estonia (21), Macedonia (23), and Latvia (25th). Out of the top 50 rankings, European countries made up nearly half, with 24 nations placed in the top fifty.

Reflecting the challenging business environment of many key emerging markets, China ranked 91st in terms of ease of doing business in 2013, while India ranked 132nd. Brazil clocked in at 130th.

Ease of Doing Business Rankings: Top 25

Economy	Rank
Singapore	1
Hong Kong SAR, China	2
New Zealand	3
United States	4
Denmark	**5**
Norway	**6**
United Kingdom	**7**
Korea, Rep.	8
Georgia	9
Australia	10
Finland	**11**
Malaysia	12
Sweden	**13**
Iceland	**14**
Ireland	**15**
Taiwan, China	16
Canada	17
Thailand	18
Mauritius	19
Germany	**20**
Estonia	**21**
Saudi Arabia	22
Macedonia, FYR	**23**
Japan	24
Latvia	**25**

Data as of March 2013 Source: World Bank: Doing Business Report 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 variables need to be factored into the equation, like the rise of state capitalism in many developing nations, continued intellectual property right infringements, 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 micro climate 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 twenty-five. Switzerland ranked first, Finland 3rd, Sweden 4th, the Netherlands 5th, Germany 6th, and the United Kingdom 8th. Meanwhile, Denmark ranked 12th, Norway 15th, Austria 16th, Belgium 17th, France 21st, and Luxembourg 22rd.

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 ranked 96th in the latest survey, the worst performer among EU members.

The spread between number one 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 systems and flexible labor markets; Spain's ranking was hurt by macroeconomic imbalances but scored relatively well in terms of 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 largest domestic market, among other things.

Top 30 rankings in the Global Competitiveness Index 2012-2013

Economy	Rank	Score
Switzerland	**1**	**5.72**
Singapore	2	5.67
Finland	**3**	**5.55**
Sweden	**4**	**5.53**
Netherlands	**5**	**5.50**
Germany	**6**	**5.48**
United States	7	5.47
United Kingdom	**8**	**5.45**
Hong Kong	9	5.41
Japan	10	5.40
Qatar	11	5.38
Denmark	**12**	**5.29**
Taiwan	13	5.28
Canada	14	5.27
Norway	**15**	**5.27**
Austria	**16**	**5.22**
Belgium	**17**	**5.21**
Saudi Arabia	18	5.19
Korea, Rep.	19	5.12
Australia	20	5.12
France	**21**	**5.11**
Luxembourg	**22**	**5.09**
New Zealand	23	5.09
United Arab Emirates	24	5.07
Malaysia	25	5.06
Israel	26	5.02
Ireland	**27**	**4.91**
Brunei Darussalam	28	4.87
China	29	4.83
Iceland	**30**	**4.74**
Estonia	34	4.64

Data as of September 2012

Source: World Economic Forum: Global Competitiveness Report 2012-2013

Moreover, although the overall U.S. ranking was quite high, the United States lagged behind many European nations when it came to infrastructure, health and primary education, and technology readiness. Amazingly, the U.S. ranked one notch lower on technology readiness than Portugal. In terms of innovation and sophistication factors, the U.S. ranked 6th overall, lagging behind Sweden (1st), Switzerland (2nd), Finland (4th) and Germany (5th).

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 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 2013, Switzerland, Denmark, Sweden, Finland and Germany rank as innovation leaders in Europe.

According to the 2013, 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 EU 27 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 the Czech Republic, Greece, Hungary, Italy, Lithuania, Malta, Portugal, Slovakia, and Spain was below that of the EU average, as were the performances of Bulgaria, Latvia, Poland and Romania, the laggards among the EU Member States.

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 25% of total global R&D in 2010 and 2011. That lagged the share of the United States (32% in 2011) but was well ahead of the global share of R&D spending in Japan (11.4%), China (13.1%), and India (2.8%). In 2011, Germany, Sweden, Switzerland, and Finland spent more on R&D as a percentage of GDP than the United States.

Led by European industry leaders like Novartis, Roche, Nokia, Volkswagen, Sanofi, GlaxoSmithKline, Daimler, and AstraZenca, Europe remains a leader in a number of cutting edge industries including life sciences, agriculture and food production, automotives, aerospace, nanotechnology, energy, and information and communications. The European firms just listed are part of the Innovation Top 20; note from the table that eight 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

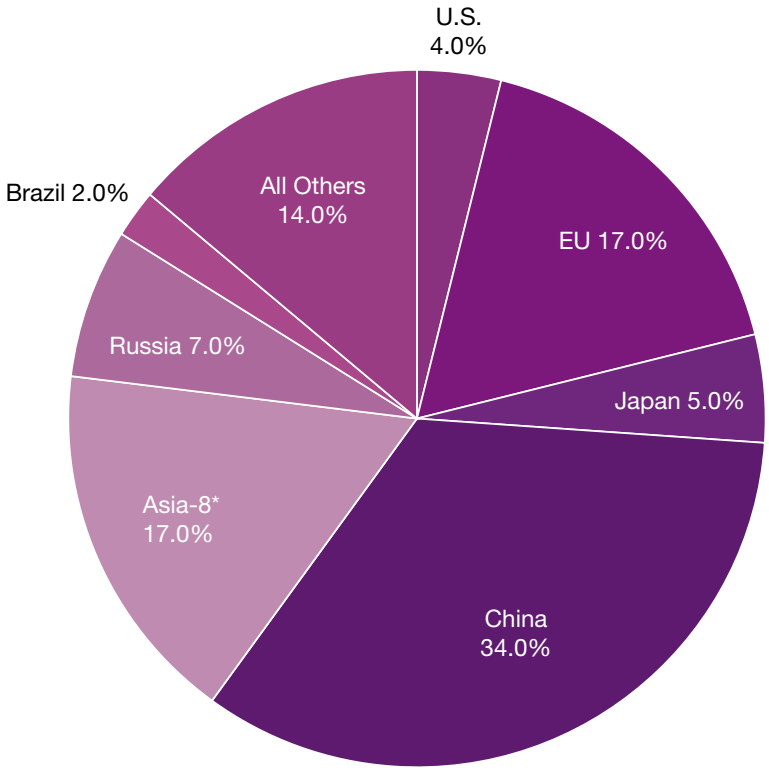
R&D Spending					
Rank 2011	Company	2011, $US Billions	Change from 2010	Headquarters Location	Industry
1	Toyota	9.9	16.5%	Japan	Auto
2	Novartis	9.6	5.5%	Europe	Healthcare
3	Roche Holding	9.4	-2.1%	Europe	Healthcare
4	Pfizer	9.1	-3.2%	North America	Healthcare
5	Microsoft	9.0	3.4%	North America	Software and Internet
6	Samsung	9.0	13.9%	Asia	Computing and Electronics
7	Merck	8.5	-1.2%	North America	Healthcare
8	Intel	8.4	27.3%	North America	Computing and Electronics
9	General Motors	8.1	15.7%	North America	Auto
10	Nokia	7.8	0.0%	Europe	Computing and Electronics
11	Volkswagen	7.7	26.2%	Europe	Auto
12	Johnson & Johnson	7.5	10.3%	North America	Healthcare
13	Sanofi	6.7	15.5%	Europe	Healthcare
14	Panasonic	6.6	6.5%	Japan	Computing and Electronics
15	Honda	6.6	15.8%	Japan	Auto
16	GlaxoSmithKline	6.3	3.3%	Europe	Healthcare
17	IBM	6.3	5.0%	North America	Computing and Electronics
18	Cisco Systems	5.8	9.4%	North America	Computing and Electronics
19	Daimler	5.8	26.1%	Europe	Auto
20	AstraZeneca	5.5	3.8%	Europe	Healthcare
	Top 20 Total	**153.6**	**9.9%**		

Source: Booz & Company

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 18% of global natural science graduates in 2008, the latest available data. America's share was 10% of the total. The EU's share of global engineering degrees (17%) was even more impressive relative to America's—with the later accounting for just 4% of global engineering degree.

According to the National Science Board, of the world's global research pool, the EU housed 1.5 million researchers in 2008 versus 1.4 million in the United States. The EU accounted for 25% of the global total.

Europe leads the way: Number of first university degrees (engineering)
(% of global total)



**Asia-8: India, Indonesia, Malaysia, Philippines, Singapore, South Korea, Taiwan, Thailand*

Source: Organisation for Economic Co-operation and Development: Science and Engineering Indicators, 2012

In specific industries, the EU remains notably strong in such high-technology manufacturing industries as pharmaceuticals and scientific instruments and aerospace. Against this backdrop, the EU is the largest exporter of commercial knowledge-intensive services (excluding intra-EU exports), accounting for about 30% of the world total in 2010. The U.S. share was 22%. Supporting Europe's top position in service-related exports is the fact that among other regions of the world, Europe is the world's most globally connected on Earth based on the DHL Global Connectedness Index for 2012.

The 2012 DHL Global Connectedness Index, Overall Results

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
	BRIC's
62	India
68	Russia
74	China
77	Brazil

Source: DHL Data as of April 2013

Finally, in terms of future workers, the U.S. high school graduation rate lags behind most European nations; indeed, the US ranked 18th out of 25 OECD nations for graduation rates in 2008, trailing such EU states as Germany, Ireland, Finland, Greece, Norway, the UK, Switzerland, Iceland, Czech Republic, Italy, Denmark, Poland, Slovakia, and Hungary.

While US 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."[i]

A final point to consider regarding what's right with Europe: while hard to fathom given the current blizzard of bad news emanating from the region, there is still a chance that at the end of the day, the Eurozone and European Union 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 Stability and Growth 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 States' 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 are being adopted that will make Europe stronger and more integrated in the future.

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

	Europe	United States
Aerospace and defense	1.50	1.13
Automobiles and parts	1.26	0.58
Biotechnology	0.32	2.20
Chemicals	1.31	0.64
Commercial vehicles and trucks	1.30	1.06
Computer hardware and services	0.08	1.39
Electrical components and equipment	1.56	0.18
Electronic equipment and electronic office equipment	0.18	0.37
Fixed and mobile telecommunications	1.53	0.20
Food, beverages, and tobacco	0.92	0.74
General industrials	0.61	1.49
Health care equipment and services	0.70	1.86
Household goods	0.84	1.60
Industrial machinery	1.84	0.24
Industrial metals	1.00	0.30
Internet	0.00	2.54
Oil	1.00	0.85
Personal goods	1.44	0.69
Pharmaceuticals	1.27	1.16
Semiconductors	0.50	1.72
Software	0.51	2.05
Support services	0.78	1.19
Telecommunications equipment	1.38	1.09

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

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 and lacks a fiscal union, appropriate governing institutions, and mechanisms by which 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.

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.

One cannot rule out that after all the drama of the past two 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, the weak link of the global economy at the moment, 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 technological out in front in many key global industries.

Due to all of the above, Europe will remain a critical and indispensible geographic node in the global operations of U.S. companies. Remember: U.S. 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," page 0-3.

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 (Gerorgetown 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).

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 European Union 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.

The European Union is an unusual blend of developed market economies (the EU-15) and developing markets (the EU-12), and when fused, the two halves offer some of the best commercial opportunities in the world. The EU-12 members, for clarification, include the nations that joined the EU since 2004.

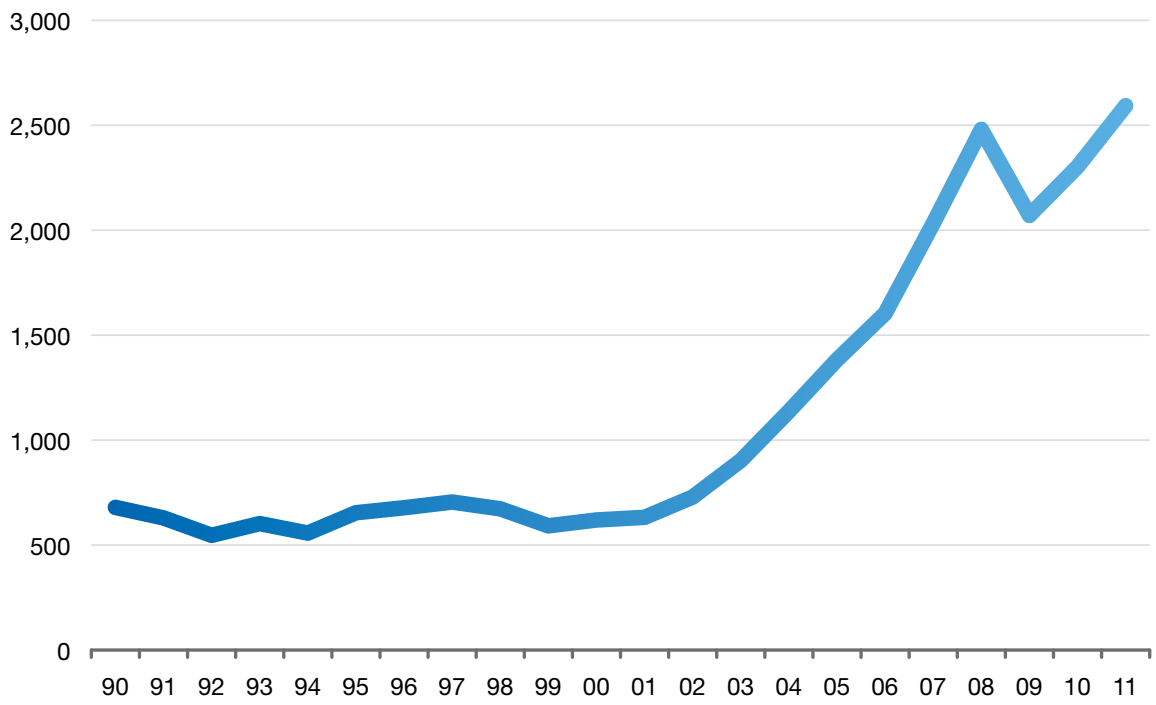
Indeed, the western/central and eastern European dynamic has been hugely beneficial to those U.S. firms embedded in the European Union. EU enlargement has meant not only the geographic extension of Europe but also the enlargement of market opportunities, resources and profits in the east for U.S. multinationals.

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, more than 12% of corporate America's European workforce is now based in central and eastern Europe, up from virtually zero two decades ago. Affiliate employment in the region expanded at an average annual pace of 8.7% between 1999-2009 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 (54,800) or even Japan (75,200) and South Korea (56,700) 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. $)



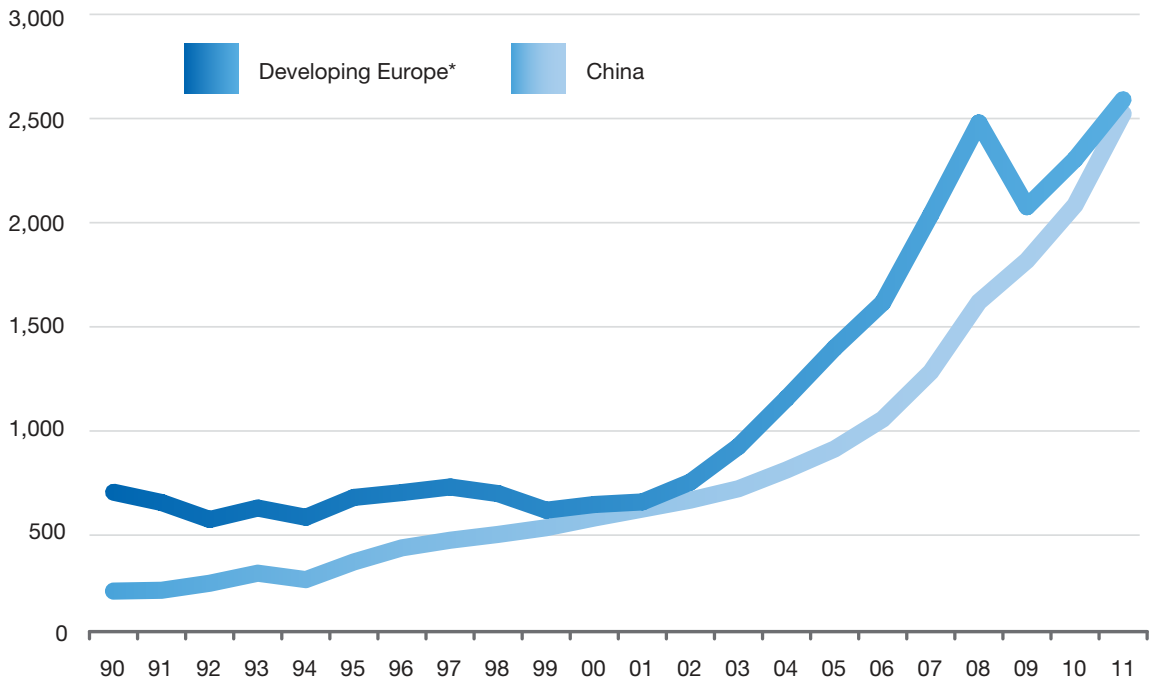
**Developing Europe includes EU-12 plus Albania, Bosnia and Herzegovina, Croatia, Macedonia, Montenegro, Serbia, Turkey, Armenia, Azerbaijan, Belarus, Georgia, Moldova, Russia, and Ukraine.*

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 2011, 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.

More impressive still is this: the consumer in developing Europe outspends consumers in China—a statement that runs contrary to the common narrative that China is the largest market in the world for virtually everything. For example, the combined personal consumption expenditures in developing Europe (Russia included) exceeded personal consumption spending in China's by 3% in 2011.

The China Next Door: Personal Consumption in Developing Europe Versus China
(Billions of U.S. $)



**Developing Europe includes EU-12 plus Albania, Bosnia and Herzegovina, Croatia, Macedonia, Montenegro, Serbia, Turkey, Armenia, Azerbaijan, Belarus, Georgia, Moldova, Russia, and Ukraine.*

Source: United Nations

In the end, consumption is serious business in central and eastern Europe, with consumption accounting for nearly 58% of GDP in 2011. 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, has translated into ever-rising sales revenue for U.S. foreign affiliates. Combined U.S. foreign affiliate sales in Poland, Hungary and the Czech Republic surged roughly 240% between 2000 and 2010, rising from $21 billion to $70 billion. The latter figure, incidentally, was over 40% 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 2010 — $1.2 billion — was well above levels reported in the more developed markets of Finland, Greece, Italy, Portugal, 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 to 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

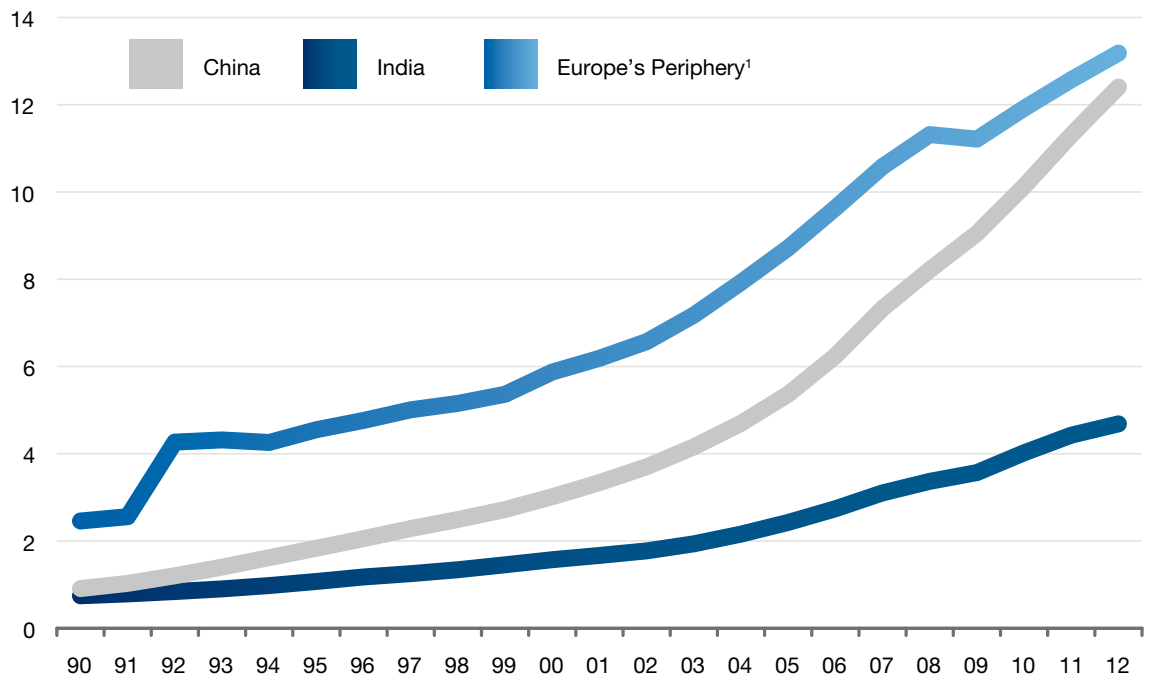
Europe's extended periphery—defined here as central and eastern Europe, including Russia; the Middle East, Turkey included; and Africa, notably North Africa—is unmatched on a global scale. While only two nations abut the United States, a dozen or so nations are considered a part of Europe's immediate 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 European Union, that has not stopped bilateral trade from soaring over the past decade, with total EU-Turkey trade expanding 247% between 2000 and 2011. Total trade between Russia soared 561% over the same period; trade with Nigeria and its exploding middle class jumped 327% between 2000 and 2011. European-based U.S. affiliates have been a part of this surge in bilateral commerce, leveraging Europe as a springboard to the untapped and undeveloped markets surrounding mainstream Europe. In most cases, it is too costly to serve these distant markets from the United States; 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 larger than China's total output. In 2012, the periphery nations produced $13.2 trillion in output versus China's $12.4 trillion (numbers are based on PPP). Relative to India, well, it's not even close, with India's output just 36% of Europe's periphery in 2012. 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[1] vs. China/India
(Trillions of $)



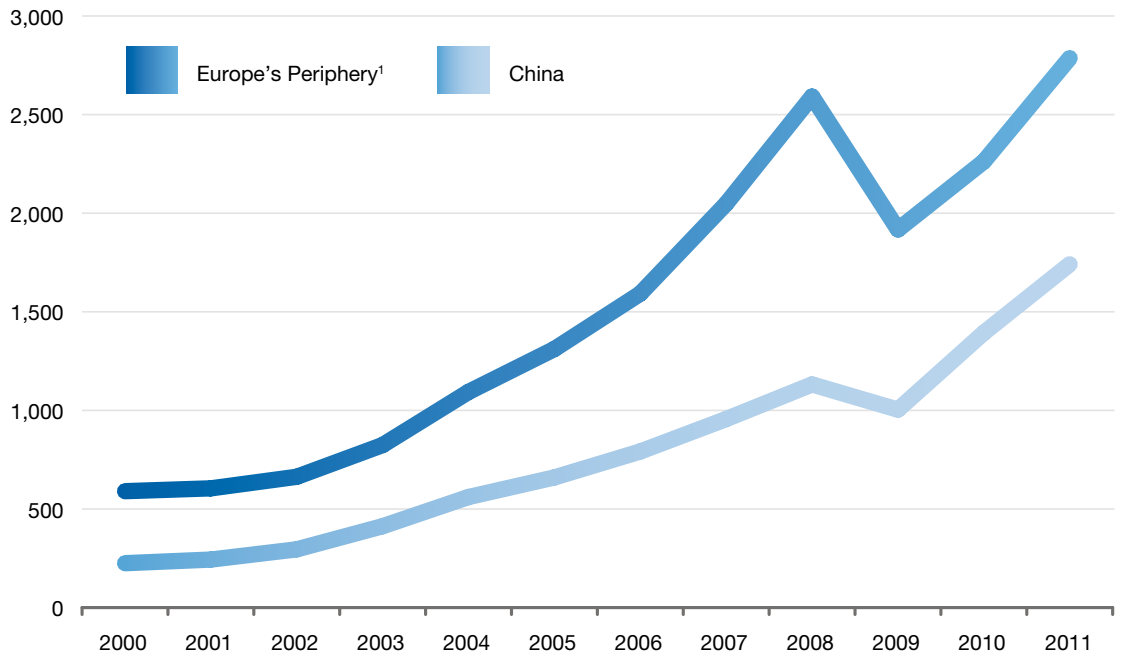
[1]Europe's Periphery: Developing Europe, Middle East, North Africa and Sub-Saharan Africa
Source: International Monetary Fund

Parts of Europe's periphery are incredibly wealthy—think of the Middle East and the elevated per 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 a staggering $2.8 trillion in goods imports in 2011—that is 60% larger than total 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 decade and more importantly, is expected to remain relatively robust over the next decade.

Who needs China? Total Imports of Europe's Periphery[1] vs. the Middle Kingdom
(Billions of $)



[1]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 European Union—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 EU's European Neighborhood Policy program).

Meanwhile, the EU was the top supplier to the Middle East/North Africa (with a 27% share in 2011), sub-Saharan Africa (26%) and to Russia and its partners in the Commonwealth of Independent States (31%).

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 European-based affiliates to penetrate these markets.

U.S. firms "inside" the European Union 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 constructive. 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 contract by 0.2% this year, underperforming expected growth in central and eastern Europe (2.4%), the Commonwealth of Independent States (3.8%), the Middle East and Africa (3.4%), and sub-Saharan Africa (5.8%). In many parts of the periphery, higher energy and commodity prices have generated huge surpluses, spurred investment and boosted public spending.

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	**63.5%**	**EU**	**26.2%**	**EU**	**26.1%**	**EU**	**31.3%**	**EU**	**10.6%**	**EU**	**12.9%**
U.S.	2.7%	U.S.	7.4%	U.S.	6.4%	U.S.	3.5%	U.S.	7.0%	U.S.	30.6%
Japan	1.0%	Japan	3.4%	Japan	3.4%	Japan	2.0%	Japan	9.9%	Japan	3.4%

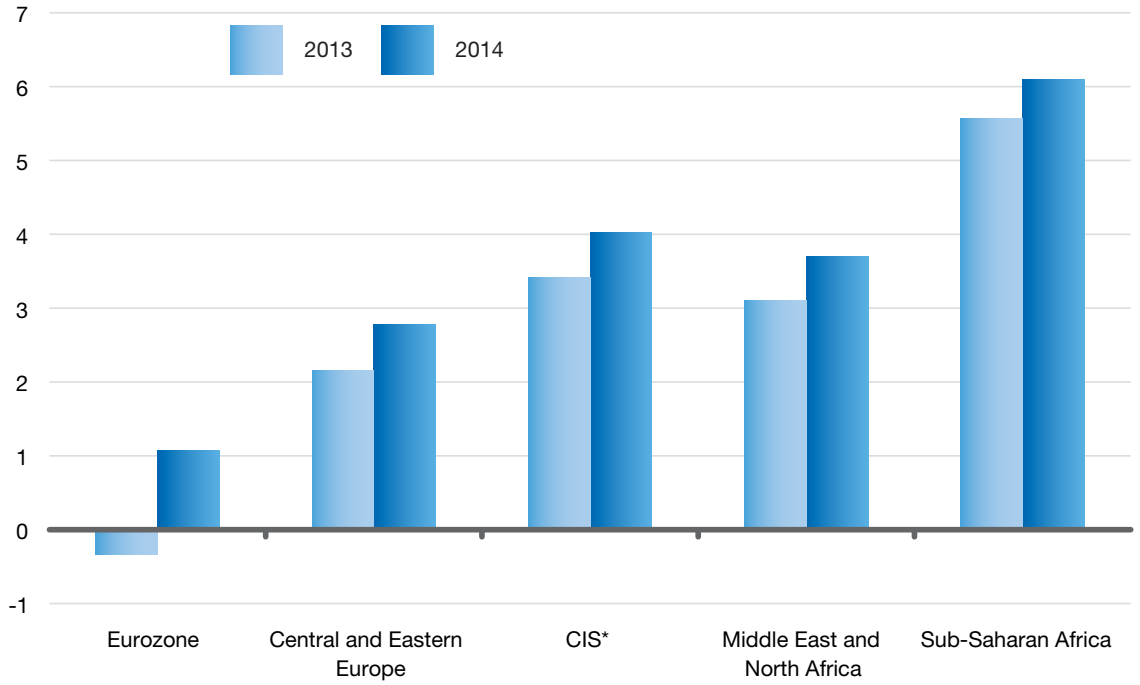
Data for 2011

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

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.

In the end, the European Union's ties with the developing nations—the world's uncontested 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 have 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.

As global reports of economic activity confirm, Europe is one of the world's four global engines. When framing Europe's 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 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 15% of world imports. These figures are impressive but so are the figures for Engine Two—Europe.

Engine Two consists of the 27 Member States of the European Union. As made clear in previous pages, the EU is the largest economic entity in the world and among the wealthiest. This engine accounts for one-fifth of world GDP and one-quarter of global consumption. In terms of trade, the EU is not only the largest exporter in the world; it is also the largest importer in the world. 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, placing great strain on the world economy. Because of malfunctions in Engine 2, global trade grew by only 2% in volume terms in 2012, with only a modest increase expected this year.

The Four Engines

	(% of World Total, 2011)			
	Engine One: North America	Engine Two: Europe	Engine Three: Asia	Engine Four: Commodity Producers
GDP (Purchasing Power Parity)***	20.8	21.4	36.2	21.7
Population	5.0	8.6	56.9	29.4
Private Consumption Expenditure*	29.0	27.4	25.6	18.0
Exports	10.9	36.0	32.2	20.9
Imports	15.0	35.8	30.1	19.1
International Reserves**	2.1	11.6	60.3	26.0

Sources: International Monetary Fund, Economist Intelligence Unit, United Nations Population Division, U.S.Trust Market Strategy Team.
**Personal or household consumption expenditure.*
***Excluding gold*

****Data for 2012*

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.

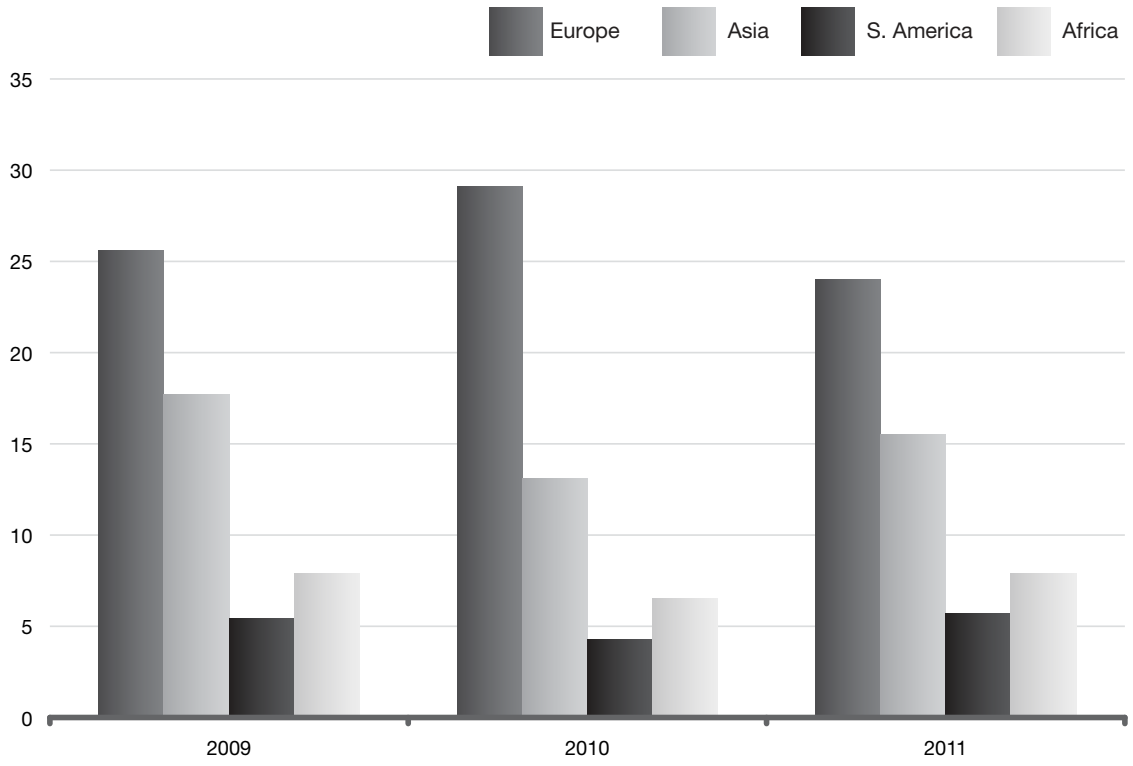
The same ill effects have been quite apparent among the world's top commodity producers that make up the bulk of Engine Four. Their export receipts have softened with the EU-led downturn in global demand.

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 profit growth can forgo Europe.

This point is underscored in the graph below, 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 total (24% in 2011, the last year of available data) versus Asia (15.5% 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 endorsement Corporate America has given to Europe over the past six decades, with no other region of the world attracting as much time and capital from U.S. firms.

Foreign Sales of the S&P 500 Companies
(% of foreign sales by region)



Source: S&P Dow Jones Indices. Data as of April 2013.

And this confidence, in general, has paid handsome dividends over the past few decades. Indeed, the graph on the next page 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 in 1990 to $66 billion in 2000. 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 last year.

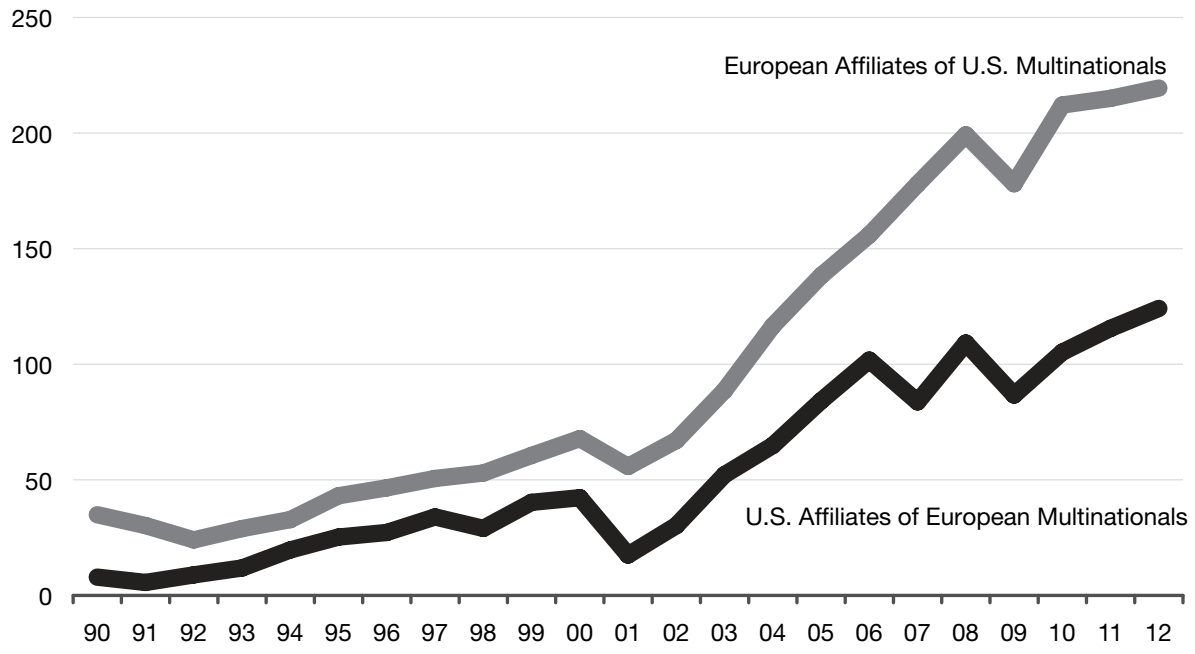
Transatlantic profits—the long view

Not only did profits soar over the period, but the profits boom, recall, took place amid a 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 worse global recession in decades. 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, have underpinned more output and employment growth in Europe, more R&D expenditures across the continent, and more bilateral 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. To the latter point, the gross output of American affiliates in Ireland represented roughly one-quarter of the nation's gross domestic product in 2011, a staggering sum and presence of U.S. affiliates.

Meanwhile, the more profitable U.S. affiliates are in Europe, the more earnings available are 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.

Transatlantic Profits - Affiliate Income
(Billions of $)



Source: Bureau of Economic Analysis
Data through 2012

Being a part of Europe, or being "inside" the European Union means being inside the largest economic entity in the world, and having the wherewithal to leverage Europe's competitive advantages, which can take the form of hiring life scientists in Ireland to conduct R&D, collaborating with a Swiss research center, tapping the university talent of Grenoble, France, or participating in numerous government-sponsored R&D projects and commercializing the outcomes in advanced manufacturing centres across the continent.

Another reason 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 European Union. And given the potential of the massive market for various services in Europe, many U.S. firms are doing just that.

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.

Presently, national regulations are in need of greater harmonization, a process that would help remove significant barriers to entry for external 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 activities like Internet sales and e-commerce in general are far less developed in Europe. Europe, for instance, accounts for roughly 10 percent of global e-book sales (mostly in the United Kingdom), versus the U.S. share of roughly 80 percent. Online music storage and sharing services are underdeveloped as well, with national regulations making it difficult for companies to operate. Meanwhile, as the World Bank notes, 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.

However, the implementation of the Services Directive in the EU Member States has been slow and uneven in many sectors to date. Cross-border trade, nevertheless, has increased over the past decade, with service exports by Europe and developing nations roughly doubled between 2004 and 2011. While the internal market for services is less integrated than goods, it is still the largest in the world, estimated at $4 trillion by the World Bank.

E-commerce remains in its infancy, with 3-4% of Europe's goods and services sold via the web; however, according to the European Commission, the percent of Europeans who bought something online in the past year increased from 20% to 40% between

2004 and 2010, and more than likely increased over the past two years. Many expect online shopping in the EU to expand by double-digits per annum over the next few years. Recognizing the potential of e-commerce and its offshoots, the European Commission earlier this year announced the goal of creating a "digital single market", with the aim of doubling e-commerce retail sales by 2015.

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.

LIBERTY GLOBAL

Focus: Liberty Global

Liberty Global is a leading international cable company with operations in eleven European countries. Liberty Global has 15,000 employees across Europe and has been in Europe since 1990. The company's headquarters are in Denver, London, and Amsterdam. On average the company reinvests 20-25% of its revenue as capital expenditure on annual basis depending on the country.

Liberty Global is the biggest cable company outside the U.S. and the largest cable television operator in most European markets where it operates. Across the majority of its footprint, Liberty Global provides video, broadband internet, and voice services under the UPC brand to residential consumers, with UPC available in Austria, the Czech Republic, Hungary, Ireland, the Netherlands, Poland, Romania, Slovakia, and Switzerland. In Germany, Liberty Global also operates under the Unitymedia and Kabel BW brands. In addition, Liberty Global has a controlling interest in publicly-traded Telenet in Belgium. Europe is also home to Chellomedia, Liberty Global's multimedia content provider headquartered in London; UPC DTH; UPC Business; and the Digital Media Centre, Liberty Global's European distribution center and the source of digital television for millions of households in Europe, in and outside of Liberty Global's footprint. In an increasing number of markets, Liberty Global offers mobile services. In Germany, the Netherlands, Belgium, Poland and Hungary, this is done through a mobile virtual network operator (MVNO) agreement with mobile network operators, allowing Liberty Global to offer mobile services and a quadruple-play to residential customers.

Liberty Global is internationally focused with an emphasis on Europe. Eleven out of thirteen countries in which Liberty Global operates are in Europe, and European investments make up a significant proportion of Liberty Global's global presence. For Liberty Global, Europe is a safe and predictable place to do business even in times of economic crises due in large part to the stable and democratic political system, rule of law, and functioning judicial systems. Europe's robust regulatory environment for digital services and infrastructure is also favorable for a company that invests in the long term horizon. European regulators also favor pan-European companies and European wide scale projects, and therefore, are supportive of Liberty Global's investments in Europe. Taken together, these conditions make Europe a more attractive market than emerging economies in other parts of the world.

With 7,000 cable operators in Europe, Liberty Global's mission is to further consolidate the market so that cable can compete more effectively with its largest competitors in Europe and to build scale in cable across Europe. Liberty Global is also dedicated to bringing real innovation to Europe with migration to 100% penetration of digital television. Focusing on innovation, Liberty Global further brings the next wave of digital TV innovation with the Horizon TV product, which combines a sector leading user interface, the integration of linear TV and non-linear content onto one platform accessible via multiple devices in the home.

As a pan-European operator, Liberty Global contributes actively to the further liberalization and harmonization of EU communications markets and believes in the positive effects of completing a digital single market.

Chapter 4

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, with President Obama pledging his support for the plan in his State of the Union address. Such a deal would not only boost growth on both sides of the Atlantic. It 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 together. 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.

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 trade, 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.

Technical regulations and safety standards are hardly headline 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 for goods and services. That in turn spells more transatlantic trade and investment, with total trade between the U.S. and EU amounting to over $500 billion last year. Cross-border foreign direct investment (FDI) between the two parties topped $300 billion last year, making U.S.-EU investment ties among the largest and thickest in the world.

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 the 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 pond. The more intense the intra-industry trade component of trade between two parties, like the one that characterizes U.S.-EU 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 bilateral trade could add up to 1.5 percentage points to growth over the medium term on both sides of the ocean. 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. The figures are not overly large but given how large the U.S.-EU economies are today—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.

In addition, given that both parties are hobbled 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.

That said, a U.S.-EU free trade agreement would do more than trigger economic activity. It would help reinvigorate a critical bilateral 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 have 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-

Comparing FTAs

(Billions of $ unless otherwise specified)	Trans-Atlantic FTA	Trans-Pacific FTA	North American FTA
GDP (Purchasing Power Parity)*	16,093	10,792	3,247
% of World Total*	19.4%	13.0%	3.9%
Population (thousands)*	503,179	476,515	150,822
% of World Total*	7.1%	6.8%	2.1%
Per Capita Income ($)*	35,087	24,918	19,866
PCE	10,195	6,783	1,744
% of World Total*	25.0%	16.6%	4.3%
Exports	5,854	2,801	802
% of World Total	32.8%	15.7%	4.5%
Imports	6,063	2,811	882
% of World Total	33.1%	15.3%	4.8%
U.S. Outward FDI Stock to…	2,094	843	410
% of U.S. Total	50.4%	20.3%	9.9%
U.S. Inward FDI Stock from…	1,573	596	225
% of U.S. Total	61.8%	23.4%	8.8%
U.S. FDI Income Earned Abroad	177	105	53
% of U.S. Total	38.7%	23.0%	11.5%
Foreign FDI Income Earning in the U.S.	95	33	13
% of U.S. Total	62.9%	22.1%	8.5%
Foreign Affiliate Sales of U.S. MNC's in…**	2,107	1,568	761
% of U.S. Total	40.8%	30.3%	14.7%
U.S. Affiliate Sales of Foreign MNC's from…**	1,609	824	245
% of U.S. Total	52.1%	26.7%	8.0%

*Sources: IMF; UN; and BEA. Data for 2011 *Data for 2012 **Data for 2010*

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 bilateral trust and cooperation.

Add in Europe's sovereign debt crisis, juxtaposed against robust economic growth emanating from China, India and the developing nations, and there is little wonder that many in Washington now believe Europe is increasingly irrelevant on the global stage. The rapidly ageing, heavily indebted, and increasingly fragmented continent is seen as a withering partner of the United States rather 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 bilateral 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 instead, 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.

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 growth and rise to the challenge of emerging powers like China is by working together, not apart.

United Technologies

Focus: United Technologies Corporation

United Technologies Corporation (UTC) is a diversified company that provides a broad range of high-technology products and services to the global aerospace and building systems industries. UTC is present in Europe with all its business units, combining European companies like Chubb that opened its first factory in the UK in 1818, and bringing in companies founded in the US such as Otis and Carrier. Today European sales represent 26% of global business and the group employs over 64,000 people in 32 countries. Through its more than 1,600 locations in Europe and more than 100 manufacturing facilities, European sales in 2012 totaled approximately US$14.9 billion.

UTC commercial businesses include Otis elevators and escalators and UTC Climate, Controls & Security, a leading provider of heating, ventilation, air conditioning, fire and security systems, building automation and controls. The group's aerospace businesses are Sikorsky aircraft and the new UTC Propulsion & Aerospace Systems, which includes Pratt & Whitney aircraft engines and UTC Aerospace Systems aerospace products. The company also operates a central research organization that pursues technologies for improving the performance, energy efficiency, and cost of UTC products and processes. UTC manufactures and services in European sites for European customers, as well as for export.

European manufacturing has a long history with highly skilled and specialized employees that are important for UTC and its suppliers. As innovation and technological developments make UTC a global leader in its fields, skilled employees, and a focus on research have been decisive to its investment and growth in Europe. UTC's research center has an important and growing hub in Ireland, focusing on future global issues around energy and resource efficiency. All UTC businesses also have specialized research units, and many of UTC's innovative technological breakthroughs are developed here.

European hubs and clusters of expertise and suppliers in certain fields drive some investment decisions. UTC has invested strongly in the aviation sector in Poland since their first joint venture in 1992, and currently employs nearly 10,000 employees there, manufacturing helicopters, engines and parts. The development of the Aviation Valley in south-eastern Poland has pooled investment, as innovation centers, suppliers and infrastructure are nearby.

Provided the right conditions are in place, UTC aims to continue to excel its efforts in manufacturing, services and R&D in a Single Market that will hopefully grow stronger. In order to accelerate its performance, UTC considers the EU and its Member States as strong partners to build a sustainable and competitive market place. Moving forward, the availability of cost-effective assets, skills and talent will be key to their success.

Focus: Eli Lilly and Company

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.

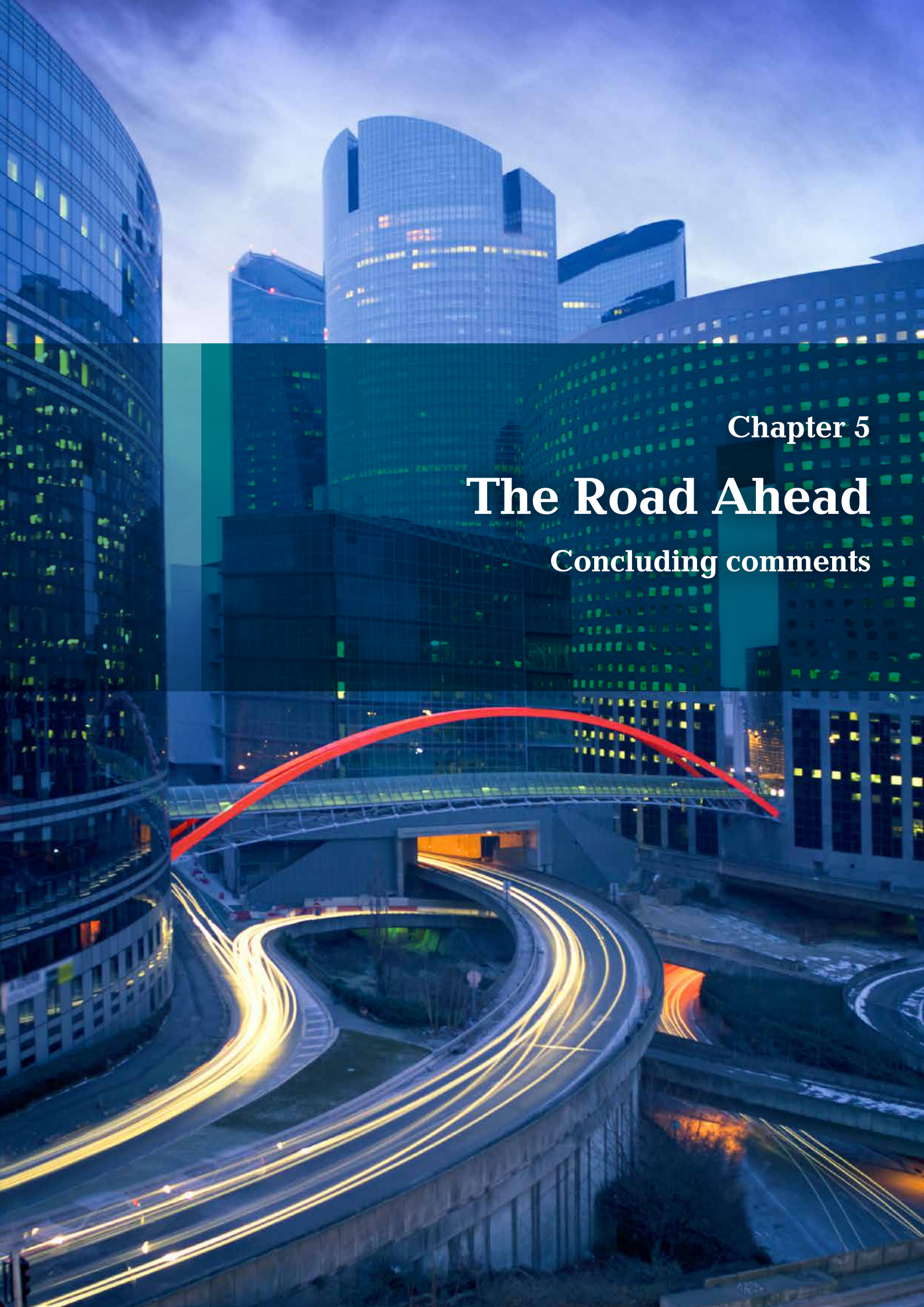
Lilly's research center in the UK is home to many of their pioneering innovations, and a center of excellence in neuroscience. There are currently over 600 people working on the site, with over 45 nationalities working across more than 30 disciplines. Lilly supports the Innovative Medicines Initiative, a joint project of the European Union 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's goal is to deliver improved outcomes for individual patients in Europe. It believes that at this moment of extraordinary scientific promise, it would be a grave mistake to sacrifice the long-term benefits of innovation to meet immediate budget pressures.

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 decision to launch negotiations for an ambitious and comprehensive EU-US free trade agreement (the Transatlantic Trade and Investment Partnership). The pharmaceutical markets in the US and the EU remain among the most significant in the world. In a period of economic crisis, 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 5

The Road Ahead

Concluding comments

It came as a bit of a surprise to the world when the Norwegian Nobel Committee awarded the 2012 Nobel Peace Prize to the European Union. The announcement, however, should not have been anything but surprising.

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."[i]

Europe is also a continent of economic success—notwithstanding current economic difficulties. The post-war economic integration of the European Union is one of the greatest accomplishments of the past sixty years. It lies at the core of Europe's peace and reconciliation, with no other region of the world as successfully bound together as the nations of Europe. Over the post-war era, Europe has not only made itself economically stronger, it's made the world economy stronger and safer as well. 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's wrong with America's key transatlantic partner. This report serves as a critical 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 base case for the European Union rests on many building blocks. First, the Eurozone not only remains intact but will in time expand to include other Member States like Poland. Second, with more pro-growth policies in the offing, the current recession is expected to run its course over the middle of this year, setting the stage for a rebound by the tail end of this year. A proactive ECB and monetary reflation, a weaker euro, solid external demand, and continued economic strength among the northern states will assist in the recovery. 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. Fourth, the institutional framework of the Eurozone has become stronger and more effective in the management of Eurozone issues. And finally, membership in the European Union 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 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 will be no different. It is going to be tough slog from here. The region is in for some lean years. Future headlines will speak about more debt restructuring, mounting political pressure, structural unemployment, and wealth transfers between rich and poor. The list goes on. This will be a multi-year process with each pressure point testing the solidarity of Europe. Yet in the end, vested interests—inside and outside 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 ageing and shrinking, U.S. firms need even greater access to Europe's labor markets. 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 has emerged as one of the most dynamic components of the global economy, with U.S. firms "inside" Europe well positioned to leverage Europe as a spring broad 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 environment, and a large pool of skilled labor that what sets the region apart from the emerging markets and makes Europe Corporate America's profit center.

In the end, notwithstanding Europe's cyclical weakness on account of the sovereign debt crisis, 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.

[i] Quote comes from press release from Norwegian Nobel Committee

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.

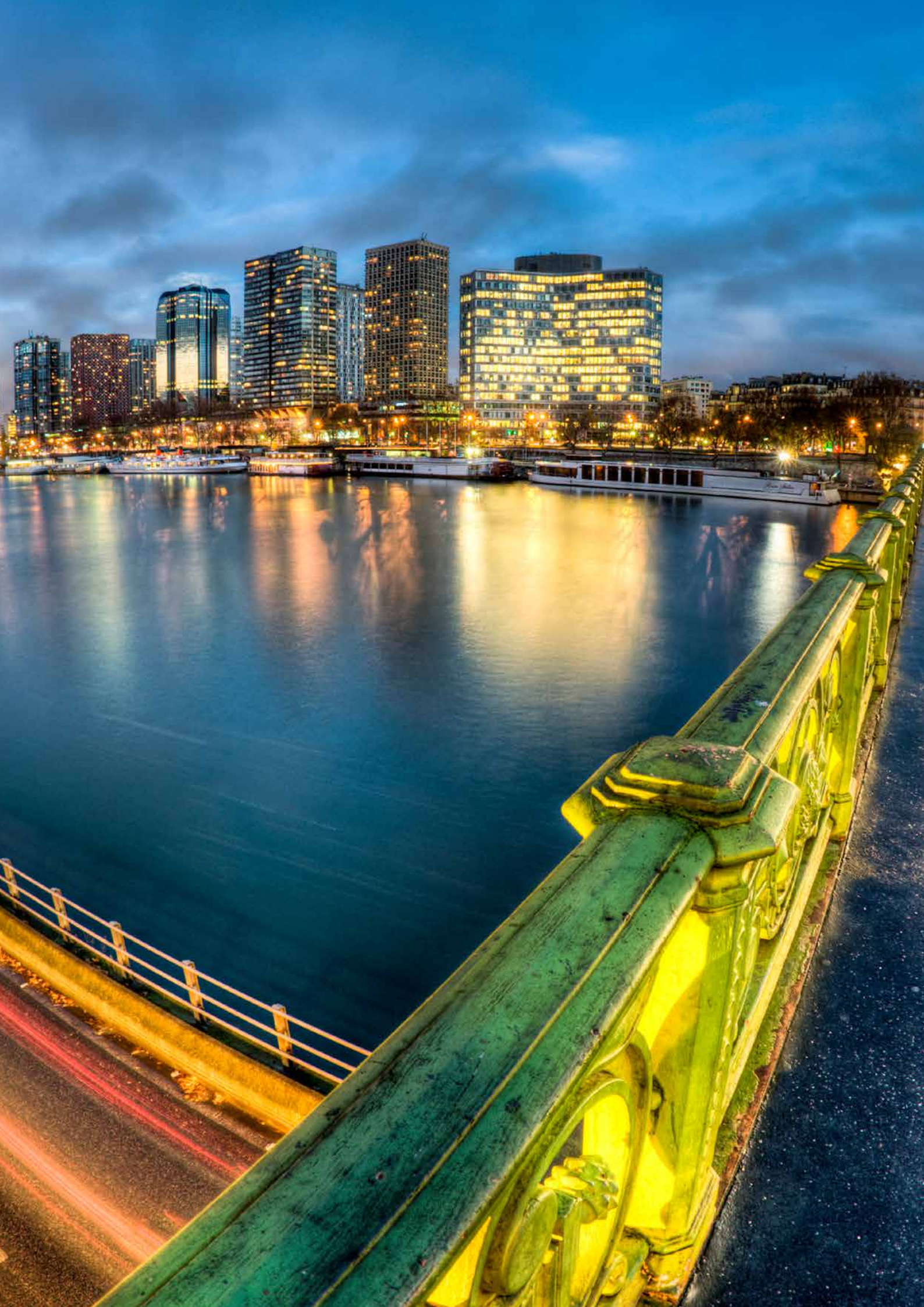
In 2006, the American Chamber of Commerce to the European Union awarded Mr. Quinlan the 2006 Transatlantic Business Award for his research on U.S.-Europe economic ties. In 2007, he was a recipient of the European-American Business Council Leadership award for his research on the transatlantic partnership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