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Time to Heal:
The Transatlantic Partnership in 2021

The last four years tested the transatlantic relationship

- Escalating trade tensions and tariffs
- Expanding restrictions on foreign direct investment
- Differing objectives on climate change
- Conflicting views over China, Russia and Iran
- Quarreling over defense spending, military deployments and even the future viability of NATO
- Deviating approaches to the WTO Appellate Body
- Disputes over privacy regulations, industrial subsidies and digital taxes
- Divergent positions on Brexit
- A once-in-a-century global health crisis

As of this writing, the COVID-19 pandemic has taken more than two and a half million lives worldwide. The United States and the European Union (EU) have each lost over 500,000 lives. Unprecedented scientific collaboration has brought us vaccines, but it will take a year or more to manufacture and deploy enough vaccines to stop the pandemic. Even after vaccination becomes routine, it is likely that the virus will remain endemic and continue to evolve, requiring vaccine adjustments and constant vigilance for years to come.[1]

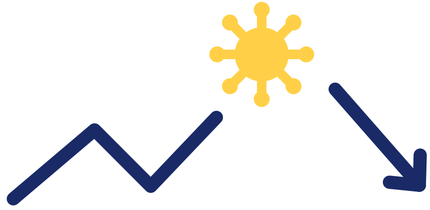
At its best, 2021 will be a time to heal. A time to move our societies and our economies from sickness to health. A time to repair and recast the transatlantic partnership. COVID-19 is an extraordinary test of transatlantic and global cooperation. It is also a transformative opportunity for the United States and Europe to build international coalitions to end the pandemic and create new economic pathways out of the recession.

Bent, But Not Broken

The last four years subjected the transatlantic partnership to the ultimate stress test: escalating trade tensions and tariffs; expanding restrictions on foreign direct investment (FDI); differing objectives on climate change; conflicting views over China, Russia and Iran; quarreling over defense spending, military deployments and even the future viability of North Atlantic Treaty Organization (NATO); deviating approaches to the World Trade Organization (WTO) Appellate Body; disputes over privacy regulations, industrial subsidies, and digital taxes; and divergent positions on the United Kingdom's departure from the EU. The icing on the proverbial cake: a once-in-a-century global health crisis that brought the global economy to its knees, spawning even more transatlantic discord and division.

In the face of these multiple headwinds, the transatlantic partnership bent. But it did not break. Even as political storms howled, the world's largest and most important bilateral commercial relationship stayed on track. The best metric of this dynamic: in 2019, one year before the pandemic rattled the global economy, U.S. foreign income in Europe hit a record high of $298 billion; meanwhile, European affiliate income in the U.S. tallied $134 billion in the same year, the second highest annual total on record. Notwithstanding outsized policy differences, transatlantic business carried on. Countries traded, tourists traveled, companies invested, profits were earned, capital crossed borders, workers worked, consumers consumed.

Owing to the devastating effects of the pandemic-induced recession, transatlantic flows of virtually everything (trade, investment, capital, people) dropped dramatically over the past twelve months. But the declines are one-off, an anomaly against a backdrop of steadily rising and solidifying transatlantic commercial ties. As we shift to the post-pandemic world, and as the transatlantic economy heals this year, we expect the bilateral flows that shape the transatlantic partnership to rebound as well.



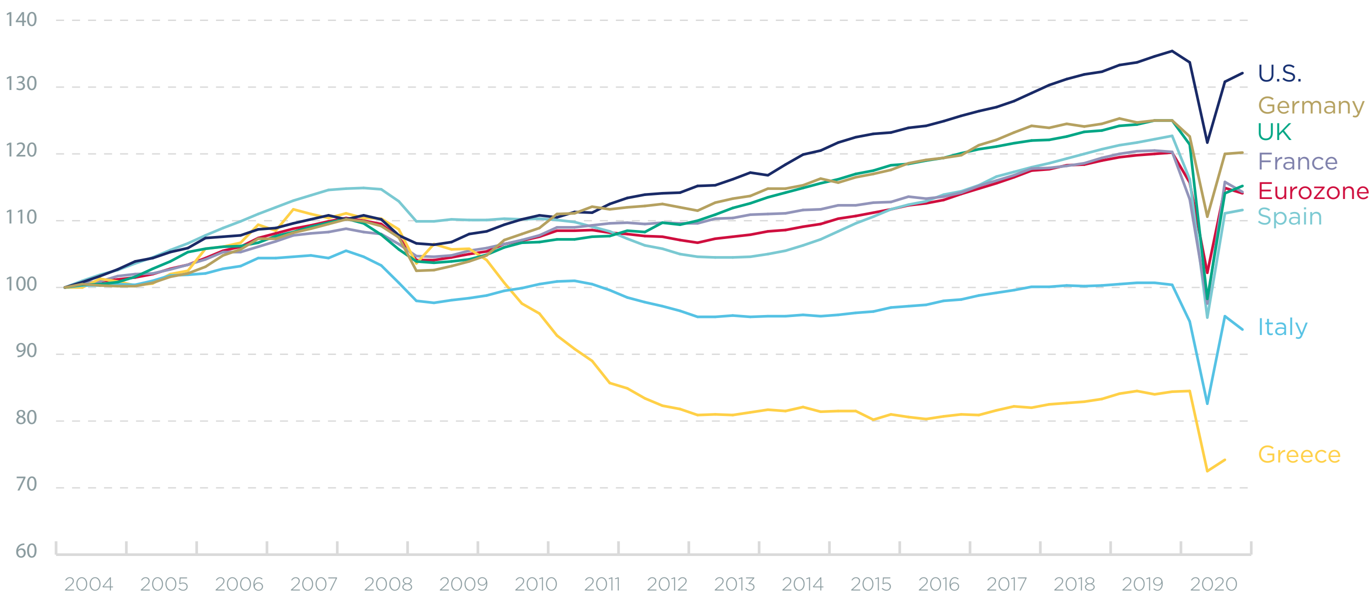
The global pandemic strongly impacted transatlantic flows, but declines are expected to be one-off.

The Transatlantic Economic Outlook: Moving From Sickness to Health

The COVID-19 pandemic will go down in history as one of the most significant global events of the modern era. It has ravaged societies and economies with unprecedented ferocity and scale. It blindsided public authorities who threw together ad hoc, uncoordinated measures ranging from cross-border travel bans to social distancing recommendations. As the pandemic swept the world in early 2020, curfews were put in place. Schools were closed. Airports became desolate canyons. Planes were grounded. Businesses were shuttered. The majority of the work force went remote. Quarantines became the norm. Students left universities for home. Stay-at-home orders multiplied; recreational venues were closed and events canceled. Never had the world experienced such a sudden hard stop.

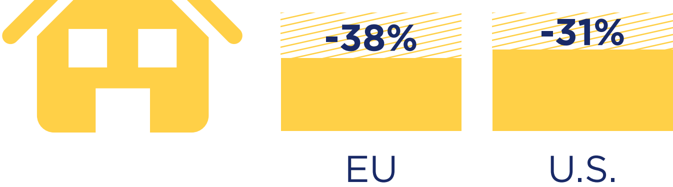
As the International Monetary Fund (IMF) noted in its annual economic outlook, "this crisis is like no other." The Great Lockdown brought the $90 trillion global economy to a near halt in the second quarter of 2020. Seasonally adjusted, in that period, EU real GDP dropped by a staggering 38% and U.S. output by 31%.

Table 1 COVID-19 Economic Downturn in the U.S. and in European Countries (Real GDP level, Q1 2004 = 100)



Source: Haver Analytics.
Greece data through Q3 2020. All other data through Q4 2020.

The Great Lockdown: impact on output



2Q 2020 GDP Decline
(Seasonally Adjusted Annualized Rate)

The health crisis quickly morphed into an economic crisis for a number of reasons. Containing the virus necessitated quarantines, lockdowns, social distancing, and stay-at-home orders – all leading to less work, less income, less spending and less mobility. Human interaction fuels economic activity, so when everyday activities of workers and consumers come to a halt, so do economies. Those sectors dependent on mobility – travel, hospitality, sports, entertainment and tourism – were hammered, even as many technology sectors profited. As factories closed, supply chain disruptions rippled across the world, exposing the fragile interconnectedness of global manufacturing networks. Consumers curtailed spending, with many opting to shop online rather than in person. This triggered a wave of business closures and layoffs, fueling more downside pressure on economic growth. And as one country after another plunged into recession, global trade volumes collapsed, putting even more downside pressure on the global economy. According to the WTO, the volume of global goods trade dropped 2% in the first quarter of 2020 and by 13% in the second quarter.

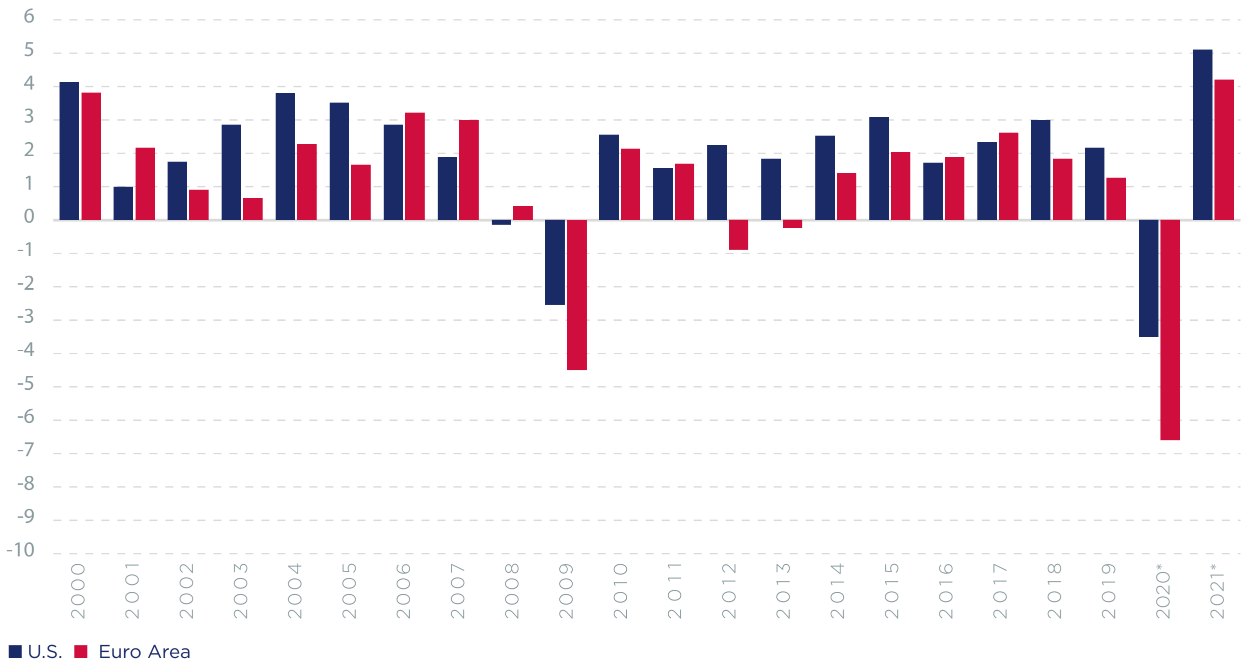
As we wrote in last year's survey, "the extent and nature of a COVID-19-induced transatlantic recession will depend on how quickly the virus can be brought under control, and the extent to which governments are prepared to help economies weather the storm."

On the former score – controlling the virus – governments have largely failed: at the beginning of April 2020, the number of daily new COVID-19 cases reported was roughly 30,000 in the United States and 36,000 in Europe. By the end of 2020, the figures were 203,000 and 239,000, respectively.[2] On the latter score, however, policy makers have fared much better. Indeed, on both sides of the Atlantic, policymakers have been extraordinarily aggressive in leveraging monetary and fiscal tools to combat the transatlantic recession, producing more a V-shaped recovery than the U-shaped rebound many forecasted.

In the United States, the combined fiscal and monetary response – some $10 trillion by the end of 2020 – represents an unprecedented 48% of GDP. The Biden administration's $1.9 trillion relief package of March 2021 will further jolt the economy. In Europe, policy makers have also stepped up in a big way. Eurozone and UK governments introduced about $7.8 trillion in fiscal stimulus and central bank liquidity injections from February to December 2020.[3]

Owing in large part to the massive policy response, the transatlantic economy is on the mend, but the rebound is not synchronized. It is uneven. The U.S. economy is leading, while Europe not only lags, it lags by a great deal. After engineering a rebound in economic growth in the third quarter of 2020, Europe's output contracted in the final quarter of the year, causing the continent to limp into 2021. Following an estimated decline in real GDP of 6.6% in 2020 – one of the steepest drops in output in the post-World War II era – the eurozone is expected to expand by 4.2% this year, assuming the pandemic is controlled and the continent is successful in rolling out vaccinations over the balance of the year. That said, the economic impact of the pandemic remains uneven across many countries and the speed of the recovery is also projected to vary significantly.[4]

Table 2 U.S. vs. Euro Area Real GDP, Annual Percent Change

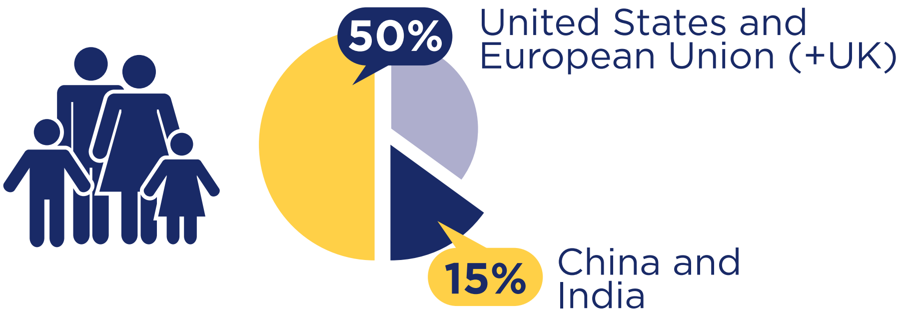


**2020 estimate, 2021 forecast.*
Data as of March 2021.
Sources: International Monetary Fund; U.S. Bureau of Economic Analysis; Eurostat.

The U.S. economy declined by 3.5% in 2020, but steadily gained momentum in the second half of the year, and is expected to expand by 5.1% this year, according to estimates from the IMF. The U.S. economy will again outperform Europe this year, but there are plenty of soft spots in the United States, ranging from weak retail demand to a battered travel and leisure industry. Meanwhile, while manufacturing activity has rebounded, services activities remain weak, creating winners and losers across the economy. The stock market has propelled average household net worth to record highs in the United States, although nearly two-thirds of Americans live paycheck to paycheck. Unemployment levels have come down somewhat from last summer's highs, but the level of unemployment remains elevated among U.S. retail workers, women and Black Americans. All of the above is another way of saying that the U.S. economy, while exhibiting signs of resiliency, confronts plenty of cyclical and structural challenges, in addition to the herculean task of distributing vaccines to hundreds of millions of Americans.

The sooner vaccines can be distributed and administered across the United States and Europe, the sooner the transatlantic economy can heal. In the near-term, COVID-19 concerns will temper consumer spending on both sides of the Atlantic, although a second-half rebound in transatlantic spending is widely expected. This is key to the transatlantic outlook, notably for European companies. At $14 trillion, U.S. personal consumption remains one of the most potent economic forces in the world, accounting for nearly 30% of global personal consumption in 2019 – greater than that of the next five largest consuming markets in the world: China, Japan, Germany, the UK, and India. Since the U.S. consumer accounts for 70% of U.S. GDP, as goes the U.S. consumer, so goes the U.S. economy – and so go the earnings of those many European firms that sell more goods and services in the United States than in their home markets. Strong U.S. consumer spending positively spills over to Europe via rising sales of European affiliates in the United States and higher European exports.

Global personal consumption (2019)

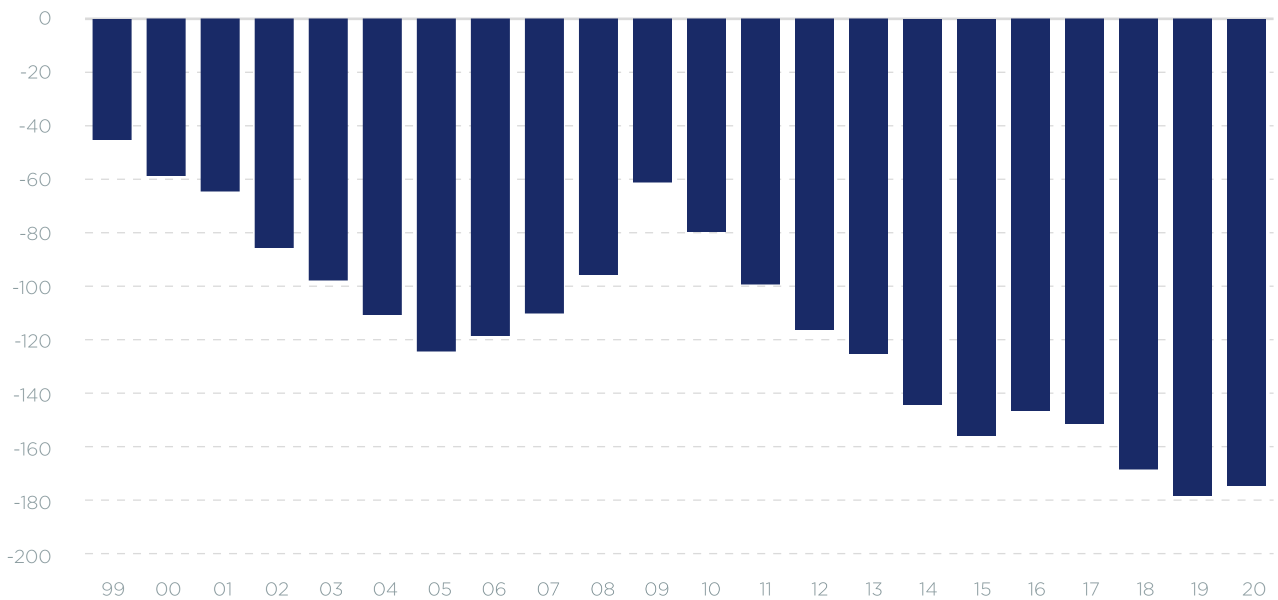


Combined, U.S. and European consumers accounted for half of world consumption in 2019, a fact that underscores the attractiveness of the transatlantic economy and reinforces a point we have made many times: despite all the talk around the rise of China, the United States and the EU still command the largest share of global consumption (50% combined in 2019 including the UK versus only 15% of China and India combined). At the end of the day, consumers in the United States and Europe are far wealthier (on a per capita basis) than their counterparts in China and India. As the pandemic passes, as vaccinations reach massive scale on both sides of the Atlantic, consumer spending will come back with a vengeance.

More spending means more transatlantic trade in 2021, following a dramatic drop in trade in 2020. U.S. goods exports to the EU in 2020 (including the UK) plunged by over 13%, while imports from the EU fell 10%. The upshot: a still sizable U.S. merchandise trade deficit with the EU (roughly $175 billion in 2020, including the UK). However, overall U.S.-European commercial interactions are far more balanced if one includes services and digital economy considerations, as we explain in Chapters Two and Four. In addition, as transatlantic economic activity revives this year, bilateral trade flows will rebound as well, although America's outsized trade deficit with the EU will remain an irritant to Washington.

We also expect the transatlantic employment picture to improve gradually this year, following historic declines in 2020. Jobs markets in both the United States and Europe are slowly set to improve. A normalized transatlantic jobs market is not expected until the vaccine has been widely distributed on both sides of the ocean and services activities rebound from the depths of recession. Entering this year, the jobless rate in the United States stood at 6.3% in January 2021, down from its peak of 14.8% in April

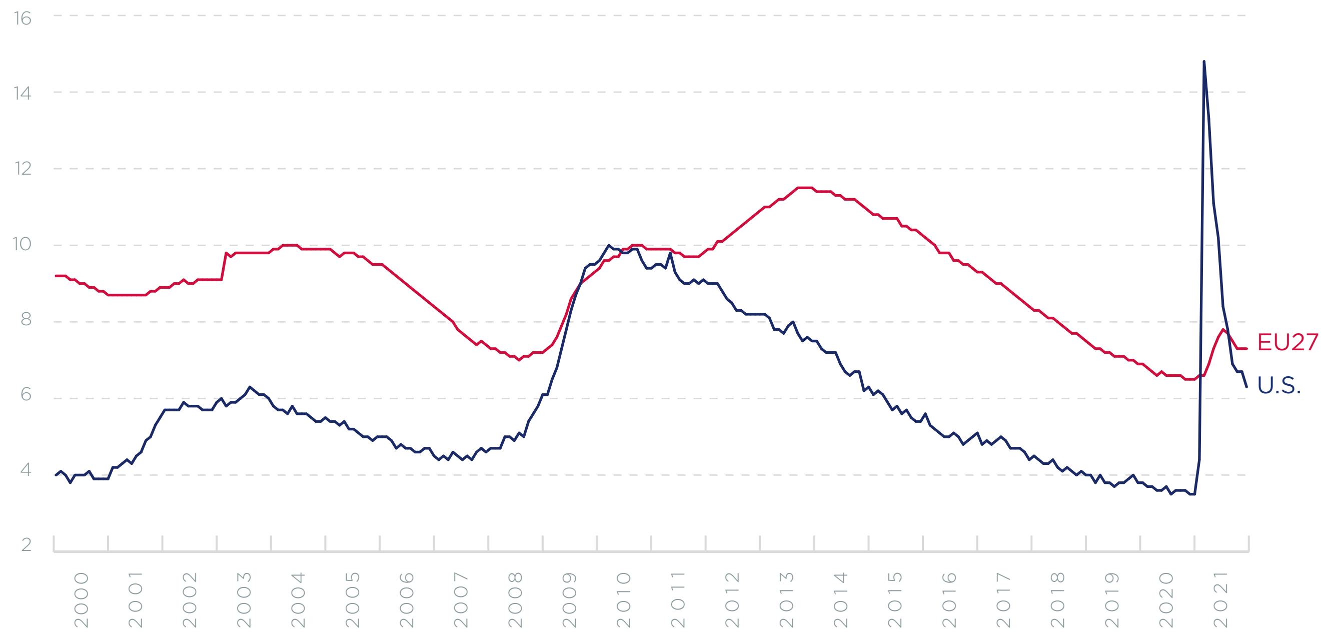
Table 3 U.S. Merchandise Trade Balance with the EU (including the UK) (Billions of $)



Source: United States Census Bureau.
Data as of February 2021

Transatlantic unemployment rate

Table 4 U.S. vs. EU Unemployment Rate Harmonized Unemployment Rate, Monthly %



Source: OECD.
Data through January 2021. EU excludes the UK.

2020, but up from a cyclical low of 3.5% in February 2020. The jobless rate of the EU27 was 7.3% in January 2021, but this figure masks widely divergent rates across the continent. In January, the jobless rate was 16% in Spain, versus an unemployment rate of just 4.6% in Germany, 3.6% in the Netherlands, and 3.1% in Poland. Structural unemployment among EU youth remains a critical challenge, just as women and minority unemployment rates remain well above the national average in the United States. The key point is this: employment prospects will improve this year due to the massive fiscal and monetary stimulus on both sides of the pond. However, structural unemployment will remain a key policy challenge again this year for all parties.

The bottom line: the transatlantic economy, led by the United States, is on the mend but many cyclical and structural challenges remain. The year begins, however, with the U.S. and EU economies on divergent growth paths, which could generate additional obstacles to transatlantic cooperation. Meanwhile, while U.S.-EU relations are poised to heal, the feel-good moment could fade if both parties fail to find common ground on dealing with China, Russia, Iran, data privacy, trade, and a host of other sticky and divisive issues.

New U.S.-EU Possibilities

U.S.-European political relations are also poised to recover after four years of tumult, uncertainty, and antagonism. Joe Biden has underscored that Europe "remains America's indispensable partner of first resort" and "the cornerstone of our engagement with the world." These sentiments, which have been echoed by European leaders, offer a rare and potentially fleeting opportunity to reinvigorate and recast the transatlantic partnership to address the unparalleled damage wrought by the coronavirus, fissures that have opened up within and between our societies, daunting climate and energy challenges, the promise and the perils of swift and often disruptive technological innovation, and revisionist assaults on our principles and our institutions.

The key to a more effective relationship is to recognize that the United States and Europe are more than foreign policy partners. U.S. relations with the EU, its member states, and non-EU European allies and partners comprise some of the most complex and multi-layered economic, diplomatic, societal and security connections that either partner has on the planet. In a world of deepening global connections, the transatlantic relationship remains the thickest weave in the web. Networks of interdependence across the Atlantic have become so dense that they transcend "foreign" relations and reach deeply into our societies. Far-reaching opportunities for transatlantic cooperation extend to interrelated issues of health, resilience, climate and energy, digital transformation, scientific and technological innovation, better jobs and sustainable growth. Almost all are rooted in the dense ties that bind the transatlantic economy.

Economics and Trade

The economic damage wrought by COVID-19, together with the ongoing climate and energy transitions, and the challenges posed by China's rise, compel the United States and Europe to focus transatlantic economic cooperation squarely on creating jobs, boosting sustainable growth, and protecting our values by ensuring that North Atlantic countries are rule-makers rather than rule-takers.

Given current economic uncertainties and lingering tensions over tariffs and digital issues, there is understandable temptation to keep transatlantic trade negotiations in the deep freeze. Yet if the United States and the EU prove unable to resolve bilateral frictions and better the terms of their own extensive commercial relationship, it will be difficult to find common ground on other issues. Unresolved issues are more likely to fester than remain frozen. Washington and Brussels will be distracted and diminished by their trade squabbles as China rises. The WTO could be at risk. Economic anxieties and political prejudices will be exacerbated. The result would be the triumph of lowest-common-denominator standards for the health, safety and welfare of Americans and Europeans alike. Standing still means losing ground.

In the current climate, the two parties might consider improving their regulatory cooperation. Sectors that show promise for U.S.- EU agreement include: automotive safety regulations; unique identification of medical devices; fiber names and labelling, safety requirements, and conformity assessment procedures in the textiles sector; cosmetics; pesticides; chemicals; information and communications technology; engineering; and technical barriers to trade. The U.S.-EU High Level Regulatory Cooperation Forum (HLRCF), established in 2005, could be revived to allow regulators to oversee such cooperation. They should consider forging a Standards Bridge that could help small- and medium-sized enterprises, and to find ways to align positions within international standard setting bodies.

The parties should separate regulatory cooperation from bilateral market access negotiations. Once progress is made on economic recovery and clearing away bilateral irritants, the parties should seek a transatlantic zero tariff agreement that would eliminate all duties on traded goods and services. That effort should exclude sanitary and phytosanitary (SPS) measures and investor-state dispute settlement (ISDS) provisions.

Third, they should intensify North Atlantic cooperation in research, development and innovation. Transatlantic partnership in these areas is essential to the future development of such leading-edge sectors as AI, biotechnology, and clean energy.

Fourth, the parties should work together to reform the WTO, by restoring dispute settlement by reforming the Appellate Body, intensifying U.S.-EU-Japan work on level playing field issues like subsidies and disciplines on state-owned enterprises, and advancing WTO negotiations on e-commerce, as well as the Trade in Health and Trade and Climate initiatives. The EU's new Trade Policy Review points to a convergence of views across the Atlantic around both the problems and potential solutions at the WTO.

The two parties would do well to consider the EU's offer of an EU-U.S. Trade and Technology Council. Such a Council could be useful if it brings strategic thinking back into the economic relationship. This was the original vision for the Transatlantic Economic Council (TEC), the cabinet-level body formed in 2007. A reinvigorated Council should include the economic policy principals on both sides, chaired at the Vice President level, with only strategic issues on its agenda.

Climate and Energy

U.S.-EU cooperation will be fundamental to ensuring the success of the climate and energy transitions underway. Because these transformations are so fundamental to each of our societies, they must be grounded in extensive stakeholder engagement on each side of the Atlantic. Initiatives must go beyond formal U.S.-EU channels and individual national government actions to engage regional, state and local actors, NGOs, and the private sector. Ultimately, businesses will be charged with making the investments, creating the markets and implementing the technologies needed to transform the energy sector. As we show in Chapter Five, U.S. and European firms are deeply embedded in each other's traditional and renewable energy markets – through trade, foreign investment, cross-border financing, and collaboration in research and development.

The two parties might consider reenergizing and revamping the U.S.-EU Energy Council as a U.S.-EU Climate and Energy Council. This Council would serve as an overarching platform for transatlantic climate and energy work, including on such priorities as forging pathways to global net zero emissions, improving energy efficiency and security, advancing renewable energy deployment, reducing methane emissions, designing sustainable finance and climate risk mechanisms, mobilizing resources for climate action in the developing world, and working on clean and circular technologies, such as renewables, grid-scale energy storage, batteries, clean hydrogen, and carbon capture, storage and utilization.

The most immediate challenge will be U.S.-EU consultations on carbon border adjustment mechanisms (CBAMs)[5] – taxes on imported goods based on their attributed carbon emissions – given that the European Commission plans to unveil its own CBAM proposal by summer 2021. Because the EU and the United States are each other's largest commercial partners, driven by significant mutual investments forming dense interlinkages across both economies, it will be important for the parties to work together to devise WTO-compatible CBAMs. Failure to do so could lead to additional trade tensions at a time when neither economy can afford them.

A Digital Agenda

The EU has offered to develop with the United States a "transatlantic technology space" that "should form the backbone of a wider coalition of like-minded democracies with a shared vision on tech governance and a shared commitment to defend it."[6] Prospects for such an initiative must be assessed against a series of digital disconnects that have roiled U.S.-EU relations in recent years. These include differences over privacy rules, taxes, antitrust laws, efforts to address dis- and misinformation, contrasting approaches to 5G security, and the EU's ambition to strengthen its "technological sovereignty," which aims in part to reduce European dependence on U.S.-based companies. In addition, the European Commission has advanced major initiatives through its Digital Services Act and Digital Markets Act that could create additional complications for U.S. investors and the new U.S. administration alike.

The two parties will need to resolve disputes surrounding taxation of digital services, potentially via ongoing negotiations at the OECD. They also need to address the July 2020 ruling of the Court of Justice of the European Union (CJEU) invalidating the U.S.-EU Privacy Shield framework that regulated some transatlantic flows of personal data for commercial purposes. The European Commission and the U.S. Department of Commerce are in the midst of renegotiating the Privacy Shield. Over the long term, however, an international agreement governing the rights of governments to access privately held commercial data for law enforcement purposes will be needed.

Despite these irritants, there are sufficient complementarities in U.S. and EU approaches to warrant intensified efforts towards a more forward-looking approach to digital issues. These could include taking up the EU's offer to intensify cooperation on digital supply chain security, and to work on a transatlantic AI agreement to set a blueprint for regional and global standards aligned with our values that can facilitate free data flow with trust. The two parties might consider an EU-U.S. Dialogue on Data Governance to address differences over data governance and flows; platform regulation and antitrust law; online content and the protection of democracy against dis- and misinformation; and governance of the future Internet. Not working together on these issues leaves the field open for non-democratic actors to set global standards instead.


Bilateral irritants, regulatory cooperation and standards
Elimination of tariffs
Research, development and innovation in cutting-edge sectors
WTO reform
Trade and Technology Council
Economics and trade
Climate and Energy Council
Cooperate on mechanisms to limit carbon emissions
Climate and energy
Opportunities for U.S.-EU cooperation
Digital
Renegotiation of the Privacy Shield
Digital supply chain security
Transatlantic standard setting on AI
EU-U.S. dialogue on data governance

Box 1.1 No Exit From Brexit

The United Kingdom left the European Union formally on January 31, 2020, but after an 11-month transition period the new UK-EU relationship truly began on January 1, 2021. Brexit is a defining moment for Britain's relations with the rest of Europe, even perhaps for its future as a united kingdom of England, Wales, Scotland, and Northern Ireland. It will affect its strategic partnership with the United States and many countries around the globe. It is also significant for the EU. Just to take one example, having lost the UK, EU capital markets have now shrunk from just over a fifth of global activity to just 13%, the same size as China.

On Christmas Eve, 2020, the UK and the EU concluded a Trade and Cooperation Agreement (TCA) regulating their future trading relationship. The deal provides tariff- and quota-free trade in goods between the two sides, which is more than the EU has offered any other advanced economy. The price was UK agreement not to undercut EU labor and environment standards and a commitment not to provide excessive subsidies to the private sector.

Although tariff-free, goods trade now faces a hard customs and regulatory border between the EU and the UK. UK and EU firms cannot assume that they can sell their goods in the other's market simply because those products have been approved by their own respective regulators. Extra red tape could cost British businesses around $23 billion a year and EU-based businesses about $19 billion, according to estimates from law firm Clifford Chance.[7] Notably, the tensions at the border are likely to get worse before they get better: initial UK grace periods for customs and sanitary checks on imports will end in the coming months, subjecting even more trade to potential delays.

The deal treats Northern Ireland, which is part of the UK, as within the EU customs area to prevent the need for a hard border on the island of Ireland, but requires checks on goods going from Britain to Northern Ireland, essentially creating a customs border in the middle of the Irish Sea.

Fisheries negotiations were contentious. The deal creates a five-and-a-half-year transition period during which EU fishing rights in UK waters ($730 million per year) will be reduced by one quarter, with British quotas increased by a corresponding amount. After the transition, access will depend on annual negotiations, such as those the EU already has with Norway.

In February 2021 the European Commission made a provisional determination – still requiring approval by EU data protection authorities and member states – that the UK appeared to offer "essentially equivalent" data protection standards to the EU. The Commission signaled, however, that it would impose "clear and strict" checks on the UK's handling of personal data, and would review the decision every four years. The ruling could be annulled should London be deemed to have departed from EU privacy standards. It could also prove vulnerable to legal challenges at the European Court of Justice.[8]

The movement of people has been constrained. Britons and EU citizens no longer have the right to go to the other's territory to work and live there on the same basis as the country's own citizens. Piecemeal visa-waiver arrangements and national right-to-work rules are now in force. UK professional services providers, such as doctors, engineers and architects, have lost their ability to automatically work in the EU; they must have their qualifications recognized in each EU member state where they want to work.[9]

Significantly, the TCA does not include meaningful provisions for trade in services, which make up some 80% of the British economy. The UK has granted temporary permission to EU firms offering a range of financial services to UK clients, but the EU has done the same only for clearing and settlement of some financial assets through UK exchanges, because a sudden loss of access would threaten the stability of the financial system. London handles about 90% of all deals in clearing houses, which prevent defaults from igniting chain reactions across markets. The EU has made clear, however, that it expects banks to move their euro-denominated trades into the bloc by mid-2022.[10]

Beyond these specific arrangements, the City of London and UK-based financial institutions have lost automatic access to the EU's single market, even though the UK has agreed to recognize EU-based financial institutions operating in the UK.[11] Major UK institutions have sought work-arounds by establishing EU-domiciled subsidiaries, but UK-EU financial flows are significantly less seamless than before.

The impact has already been dramatic. In January 2021, €6.5 billion in deals shifted immediately from the UK to the EU. Amsterdam surpassed London as Europe's largest share trading center as it recorded a fourfold increase in average traded shares per day, rising to €9.2 billion, and London lost half of its daily average value of traded shares, down to €8.6 billion. Amsterdam has also picked up activity in swaps and sovereign debt markets that typically used to take place in London. Even before January 2021, EY estimated banks had shifted €1.6 trillion in assets and sovereign debt trading to cities such as Frankfurt, Amsterdam, and Milan that would typically have taken place on venues in London. More than £4 billion, or $5.3 billion, of insurance premium income in 2019 that would typically be handled in London was written in new hubs such as Brussels.[12]

As of this writing, the two parties are discussing a memorandum of understanding on financial services that potentially could include mutual recognition of each other's rules as "equivalent," which would allow the financial industry to trade across the UK-EU border. There are no guarantees, however, and the stakes are high: Britain sells roughly £30 billion, or $40 billion, of financial services to the EU each year. It ran a surplus of £18 billion, or $24 billion, on trade in financial and other services with the EU in 2019, but a deficit of £97 billion, or $129 billion, on trade in goods.[13]

EY further estimates that about 10,000 City jobs – 4% of the total – have either been shifted to various EU cities such as Dublin, Luxembourg, Frankfurt, Paris and Amsterdam, or been displaced by firms choosing to add new roles there rather than London. Still, while some jobs have left, others have moved in. Bovill, a regulatory consultancy, found that more than 1,400 EU-based companies have applied for permission to operate in the UK after Brexit.[14]

Despite these hiccups, financial services remain one of the UK's key industries, and London remains Europe's main financial center and a dominant force in global finance. The City accounts for 43% of the turnover in the $6.6 trillion-a-day foreign exchange market and half of the daily $6.5 trillion traded in interest rate derivatives. Portfolio managers in London oversee about £8.5 trillion, or $11.3 trillion, in assets for savers in funds and mandates, making the UK the primary investment management center in Europe and the second-largest globally after the United States.

Nonetheless, Brexit's difficulties have exacerbated the pandemic-induced challenges facing companies on both sides of the English Channel, as real EU GDP dropped by 6.2%, and the UK's headline GDP fell by 9.9%, in 2020. The immediate cost to the UK of lost access to the EU has been estimated at about 1% of national income.[15] Over 15 years, Brexit will leave Britain facing a further 4% loss of potential gross domestic product compared to an alternative baseline of remaining an EU member, according to the UK's Office for Budget Responsibility.[16] Moreover, since so little was determined by the time the UK left the EU, the two parties are certain to be engaged in continuous negotiations, much like the EU and Switzerland have done for decades. However those talks may evolve, there will be no exit from Brexit. Denis MacShane, a former UK minister for Europe, calls it "Brexiternity."[17]

Box 1.2 Boeing vs. Airbus is not America vs. Europe

In March 2021 the United States, the EU and the UK began to turn a first page in their efforts to repair relations by suspending for four months tariffs the U.S. and the European partners had imposed on each other related to their sixteen-year dispute over government subsidies to Boeing Co. and Airbus SE. The tariff war was jeopardizing thousands of jobs on both sides of the Atlantic at a time when the pandemic is wreaking havoc on the airline industry. Dueling tariffs on additional industries were penalizing communities that have little to do with aerospace. It was distracting Washington and European capitals from China's far larger subsidy challenge. If the parties are serious about fully turning the page, they will use the tariff cease-fire to settle the Boeing-Airbus dispute once and for all.

This transatlantic tiff centers on the WTO's determination that the U.S., the EU, and the UK all violated their trade commitments by subsidizing their domestic aerospace industries. Germany, France, Spain, and the UK provided Airbus with financial subsidies for aircraft development. Boeing profited from tax breaks offered by the U.S. state of Washington. The WTO has authorized the U.S. to retaliate by levying tariffs on up to $7.5 billion annually on EU goods imports, and has authorized the EU to charge duties of up to $4 billion annually on U.S. goods imports. Each has imposed tariffs on aircraft as well as on a range of unrelated agricultural and industrial products. Those tariffs remain in place until a settlement is reached.

This transatlantic row is curious in a number of ways. The first is that Airbus vs. Boeing has long become synonymous with Europe vs. America, when in fact the two aerospace industries are deeply intertwined with each other, and each is a major investor and job-supplier on the other side of the Atlantic.

Boeing directly employs thousands of Europeans across countries, just as Airbus employs thousands of Americans in 38 locations in 16 U.S. states. You will find European components on every Boeing aircraft. U.S.-based suppliers and producers account for 40% of the components that make up an average Airbus jet. Over the past three years, Boeing has spent over $28 billon on its European supply chain and Airbus has spent $50 billion on its U.S. supply chain.

Maintaining these jobs and investments at a time of pandemic-induced recession and massive challenges to the aviation industry is of common interest – and yet instead of seeking solutions, both sides had expanded their target lists to inflict collateral damage on unrelated industries and agricultural producers in each economy.

The negative ripple effects of these actions are evident when one considers that the Airbus plant in Mobile, Alabama supplies aircraft to major U.S. carriers such as Delta, JetBlue, and Spirit. Since various components for those U.S.-built planes – fuselage sections, wing and wing assemblies – come from other Airbus facilities in Europe, U.S. tariffs actually penalize these U.S. airlines, who pass those costs on to U.S. consumers through increased fares.

The second curiosity is that both sides have already changed their procedures so that both are close to WTO compliance. Washington state withdrew the tax advantages it had offered to Boeing. Airbus has modified the terms on two of eight instances of illegal launch aid it had received from various governments. Now that it has identified a solution, it should not be difficult to finalize new arrangements for the remaining cases. Instead of moving on, however, both sides are relitigating their treatment of past subsidies. The only winners here are the lawyers.

A third curiosity is that the United States and Europe are investing inordinate energy squabbling over subsidies and penalizing each other's cheese, wine, and whiskey industries at a time when both face a far more significant subsidy challenge from China.

According to estimates, Beijing has subsidized the Commercial Aircraft Corporation of China, known as COMAC, with up to $72.1 billion – far more than the estimated $22 billion in European subsidies for Airbus and the estimated $23 billion in U.S. subsidies for Boeing. What's more, Chinese subsidies for COMAC are continuing, even as the U.S. and the EU have wound down subsidies for their own domestic industries.

Washington and Brussels have been quick to cry foul. Their credibility is questionable, however, when together they have been identified as subsidizers-in-chief. Until they resolve their own dispute, they are unlikely to have much leverage with Beijing.

The Boeing-Airbus dispute is a squabble we literally cannot afford. Our aerospace industries are deeply entwined with each other and with broad sectors of our respective economies. We have a mutual interest in turning the page on the U.S.-European relationship and eliminating the economic drag these transatlantic tariffs have caused. We cannot effectively challenge China's use of industrial subsidies until we resolve our own industrial subsidy dispute. Resolving Boeing-Airbus quickly, in a way that leverages our mutual strengths, would truly be an artful deal.

Endnotes

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2 Johns Hopkins University, Bloomberg. Data represents first half of April 2020 versus second half of December 2020.
3 Cornerstone Macro Research, as of December 2020.
4 2020 Estimates are preliminary estimates from Eurostat as of February 2, 2021. Forecasts for 2021 are from the International Monetary Fund January 2021 World Economic Outlook Update.
5 In essence, this mechanism would place a carbon price on imports of certain goods from outside the EU to encourage countries to raise their climate ambition and reduce the risks of companies transferring production to places with less stringent emission rules (carbon leakage).
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16 "Economic and fiscal outlook," Office for Budget Responsibility, November 2020, http://cdn.obr.uk/CCS1020397650-001_OBR-November2020-EFO-v2-Web-17
17 Denis MacShane, *Brexiternity: The Uncertain Fate of Britain* (London: Bloomsbury, 2019).