3

The Transatlantic Economy and the World

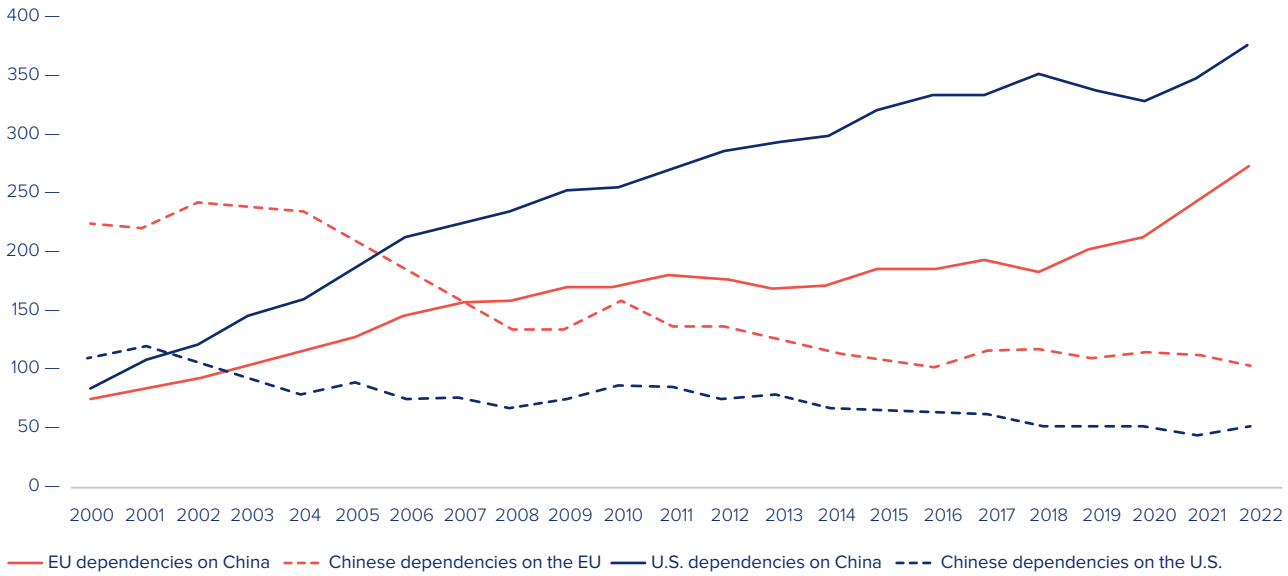
Europe and America are bound to many countries around the world, but their bonds are thickest with each other. Transatlantic trade ties – the biggest in the world – are just part of a far wider range of commercial activities. Commercial flows across the North Atlantic are more akin to a twelve-lane superhighway than a two-way trail of goods. Investment lanes and digital flows are powering traffic everywhere. Energy flows have become transatlantic lifelines. Trade lanes are bustling with goods and services. Transatlantic innovation lanes are the most intense between any two partners. Jobs lanes provide employment for over 16 million Europeans and Americans.

The densely intertwined nature of transatlantic commercial connections gives us important context to understand the role of the transatlantic economy in the world, including how best to address challenges from countries such as Russia and China. North America and Europe have mobilized their economic power to support Ukraine while sanctioning Russia, reducing their dependencies on Russian energy flows, and disentangling themselves from the Russian economy (Boxes 1 and 2). Their deeper reassessment centers on current and future threats from China.

Breaking MAD

The United States and Europe have each developed some uncomfortable dependencies on Beijing, just as key sectors of the Chinese economy remain dependent on the West. It's the modern-day version of MAD: "mutual asymmetric dependence" in place of the Cold War's "mutual assured destruction." Beijing, Washington, and European capitals are each looking for ways to minimize their vulnerabilities and leverage areas in which they are indispensable – they are all breaking MAD.

Table 1. U.S. and EU Interdependencies with China (Dependency by Number of Products, Excluding Textiles)



Source: MERICS.

Commercial flows across the North Atlantic are more akin to a twelve-lane superhighway than a two-way trail of goods.

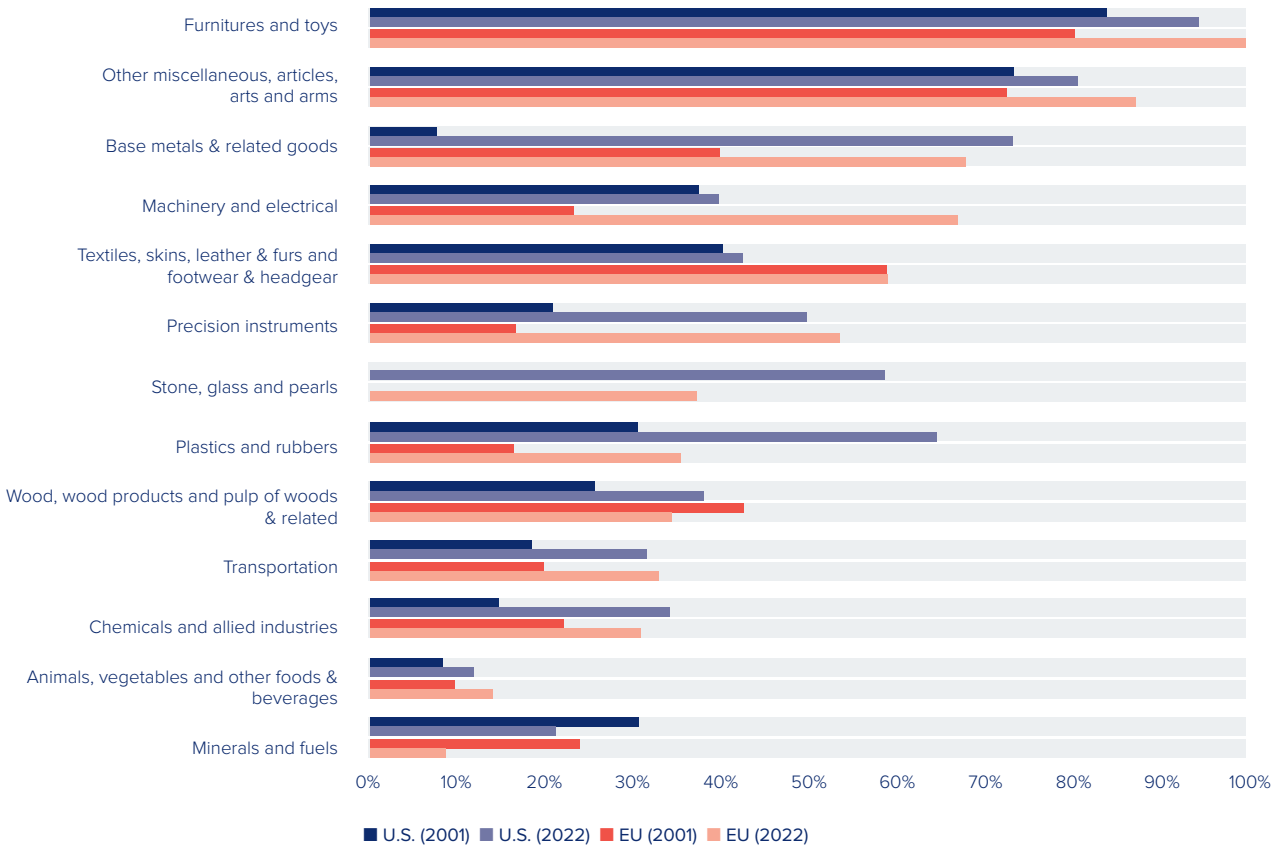
Western Dependencies

The EU and the United States have each developed critical trade dependencies on China. The U.S. in 2022 relied heavily on imports from China in 532 of just over 5,000 product categories, a near-fourfold increase from 2000, while the EU counted 421 similar import dependencies, roughly three times higher than 20 years before. EU and U.S. dependencies by value are highest for machinery and electronic equipment. The United States and Europe are also reliant on China for supplies of rare earths, a group of 17 elements needed for clean energy breakthroughs and advanced manufacturing, from smartphones and hard drives to weapons systems. China was the largest source of U.S. imports of 30 of 44 critical minerals in 2024.[1]

These figures offer two cautionary notes for Europe. First, U.S. and EU trade dependencies on China are diverging. U.S. reliance on China for exports of goods peaked in 2017, and that of China on the U.S. in 2005. In contrast, the EU's goods import reliance on China has grown while China's reliance on EU goods exports has fallen. Between 2017 and 2024, China's share of EU goods imports increased from 18 to 21% while its share of EU goods exports fell from a peak of more than 10% in 2020 to about 8% in 2024.[2]

Second, not only is the EU more exposed to China than the United States for both exports and imports, but these imports' composition has become decidedly more "strategic," shifting from textiles, shoes, toys, and furniture to electronics, pharmaceutical ingredients, chemicals, rare earths, and other critical raw materials. Chinese companies are becoming more competitive (in many cases thanks to massive subsidies) in traditional areas of EU export strength. They are exporting items higher up on the technological ladder to the EU that the EU previously exported to China. China is the source of approximately one-third of over 200 products in sensitive industrial ecosystems, for which the EU depends on third countries. The EU's import dependence on China is 90% or higher for certain pharmaceuticals, chemicals, and raw materials. Moreover, most of the EU's strategic

Table 2. Share of U.S. and EU Dependencies on China (Number of Products in Each Category)



Source: MERICS.

dependencies on China – including magnesium, permanent magnets, photovoltaic cells, and certain antibiotics and hormones – have no substitutes.[3]

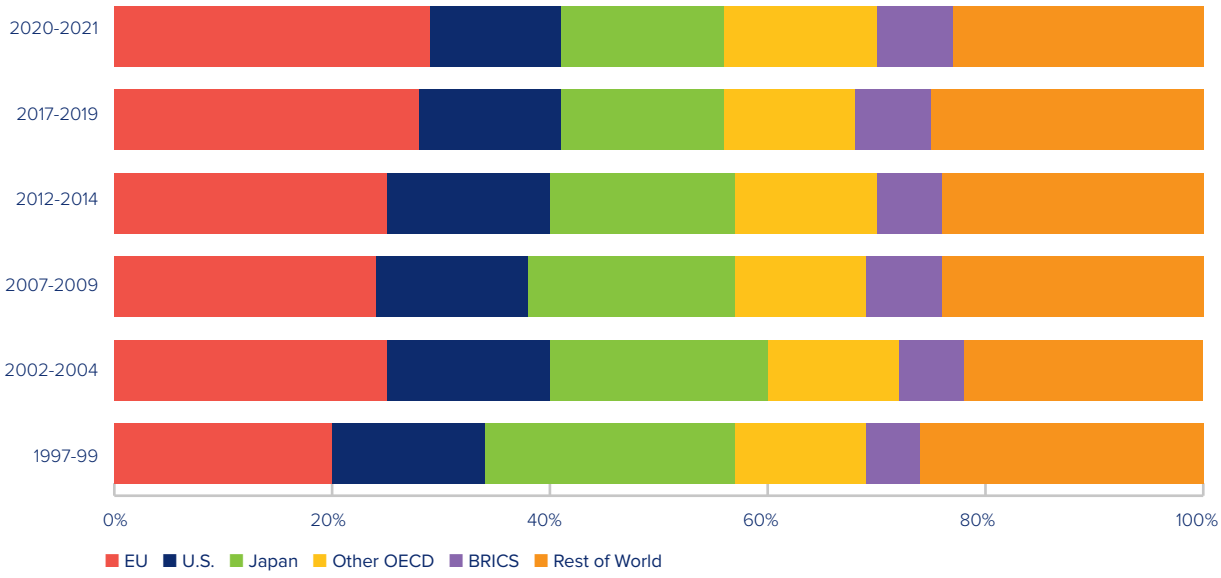
China is not only a central source for many critical materials, it has also come to dominate their value chains. In this sense, China is not only the "factory to the world," it is also the "refinery to the world." When it comes to refining iron ore into steel or pulverizing cobalt into fine purity particles for batteries, most roads lead through China. Thanks to these activities, China plays a central role in critical material supply chains. The indirect dependencies generated through these supply chains mean that some sectors of the U.S. and European economies are likely to be more dependent on China than standard metrics might suggest.[4]

In addition, even though Western companies are reducing direct sourcing from China, many remain indirectly bound to China via supply chain links with third countries. This is most evident in Asia and in Mexico, but also apparent in Europe. China is sidestepping U.S. tariffs and other U.S. and EU restrictions by exporting goods or intermediate products to third countries, which then send final goods to the North American and European markets. These transshipments make it look like Chinese exports to Western markets are falling, even though many are just being re-routed through other countries. This means that when Americans or Europeans buy from factories in places such as Vietnam, they could be buying from Chinese companies, or from Vietnam-based firms utilizing intermediate goods sourced from China.[5]

China's Dependence on the West

De-risking began in Beijing, not Brussels or Washington.[6] China since 2000 has roughly halved the number of products for which it relies on the U.S. from 116 to 57, and the number of goods for which it relies on the EU from 235 to 120. Nonetheless, China is more than 70% dependent on imports of 412 goods (worth $46.6 billion in 2021) from the United States, Europe, and other allied countries. China's high-dependency exposure to the West amounts to just a fraction of the value of its $2.7 trillion in annual imports. But any disruption to these flows would generate costly knock-on effects throughout China's supply-chains and its broader economy.[7] China's import dependency on the West is high or very

Table 3. China's Strategic Import Dependencies, by Country/Region (Share, %)



Source: OECD.

high in the areas of advanced metal and glass designing machinery, agricultural machinery, chemicals, and pharmaceutical goods. China's highest dependencies are on air and space vehicles and related parts and components, leading-edge semiconductors, grass seeds, zinc powder, silver powder critical for producing solar panels, and copper alloys used in the construction sector, imports of cobalt materials used for battery production, nickel ores and concentrates used to produce battery cathodes, and alloyed steel ingots used for shipbuilding. The U.S. and Canada account for over half of China's grain imports.[8]

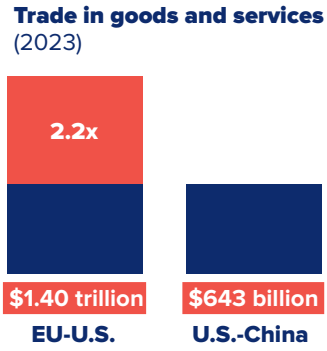
OECD countries as a group account for approximately 70% of China's strategic import dependencies. 12% of those dependencies are sourced from the United States, 15% from Japan, and 29% from the EU. Germany, Italy, France, Sweden, and the Netherlands accounted for the highest shares of China's import dependencies on the EU for strategic products. The EU share of China's strategic import dependencies is twice as high as China's share of the EU's dependencies.[9] This has prompted calls for the EU to consider how to make itself even more indispensable to China as geopolitical and commercial tensions rise.

The Transatlantic Economy in the World

China's rise has led commentators, politicians and many business leaders to proclaim regularly that it is the main commercial partner of Europe and of the United States. This is simply not true: U.S.-EU goods trade in 2024 ($976 billion) was 60% higher than U.S.-China goods trade ($583 billion) and 20% higher than EU-China goods trade ($786 billion). U.S.-EU services trade in 2023 of $447 billion was almost 7 times more than U.S.-China services trade of $67 billion and at least 4 times more than EU-China services trade of $110 billion.

In other areas of commercial activity beyond trade, transatlantic connections far exceed those either partner has with China and in almost all cases are larger than U.S. or European ties with other world regions. Each of our Top Ten metrics has showcased these differences. Let's bring them all together.

U.S. foreign direct investment (FDI) stock in the EU of $2.6 trillion in 2023 was 21 times greater than U.S. FDI stock in China of $127 billion. U.S. investment stock in the UK alone ($1 trillion) was 8.5 times greater. EU FDI stock in the U.S.



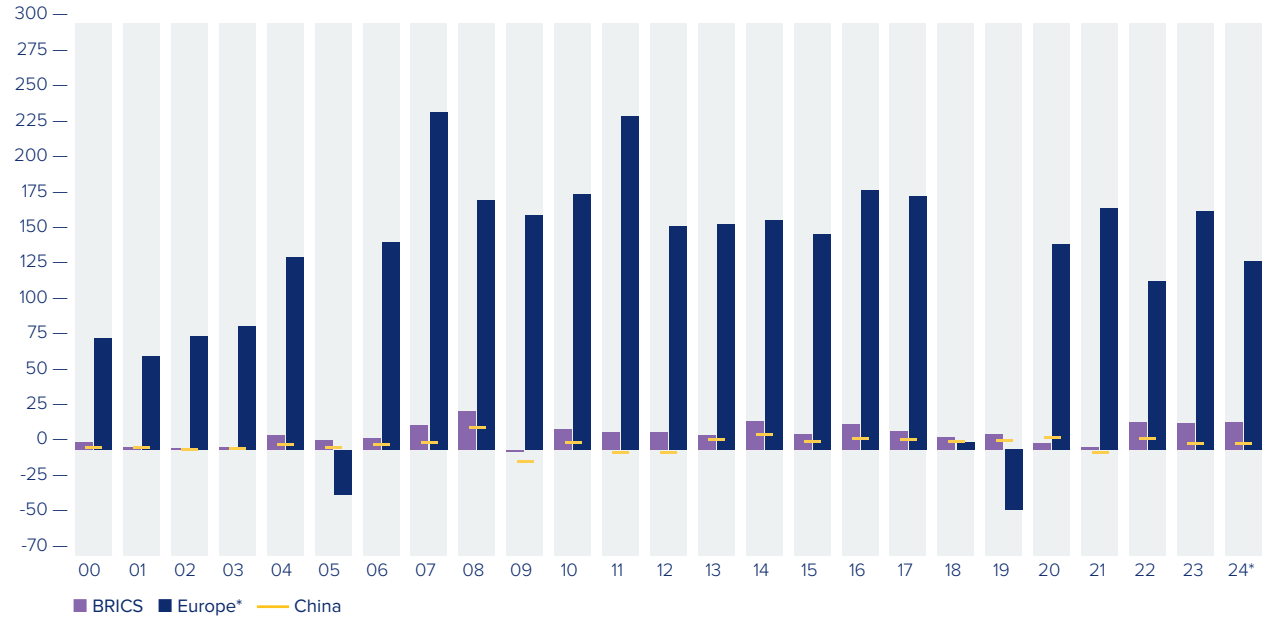
of $2.4 trillion was roughly 10 times larger than EU FDI stock in China of $249 billion. German carmakers account for more than half of EU FDI into China. The next biggest investors are from France (12%) and the Netherlands (11%). Recent investments have been driven by a push to localize production, in part to insulate China operations from geopolitical tensions and trade barriers. Once this defensive capacity is built up, EU investment in China is likely to slow.[10]

U.S. FDI stock in Europe in 2023 of $4 trillion was four times more than U.S. FDI stock in the entire Asia-Pacific region of $1 trillion, according to the U.S. Bureau of Economic Analysis (BEA). European investment stock in the United States of $3.5 trillion was 3.5 times more the level of comparable Asian investment in the U.S. of $989 billion. By country of the ultimate beneficial owner, Germany's investment stock in the U.S. of $659 billion was 23 times Chinese investment stock in the U.S. of $28 billion.[11]

Chinese FDI in the United States is meager: just eight deals worth $2.2 billion in 2024 and 7 deals worth $1.8 billion in 2023. Both are far below the 2016 peak of 63 deals worth $53.5 billion.[12] Chinese FDI in the EU in 2024 was higher, but still modest: $10.1 billion, more than the $5.6 billion recorded in 2023, but far below the 2016 peak of $42 billion. Some Chinese companies have decided to invest more in the EU, mostly in non-euro countries like Hungary, to bypass EU trade restrictions imposed on their exports and in anticipation of further trade tensions. But overall, the levels are relatively low.[13]

From 2009 to 2023, the last year of available data, Europe accounted for 56% of all FDI flowing into the United States from around the world, far ahead of the investments made by firms from the Asia-Pacific (17%), South and Central America and the Caribbean (13%), USMCA partners Canada and Mexico (12%), and Africa and the Middle East (2%).[14] European affiliates in the United States contribute

Table 4. U.S. Foreign Direct Investment Outflows to Europe vs. the BRICS ($Billions)



Source: U.S. Bureau of Economic Analysis.
*Europe does not include flows to Russia. *2024 data through Q3 2024.*
Data as of January 2025.

Strategic sectors with vulnerable supply chains for both the U.S. and the EU

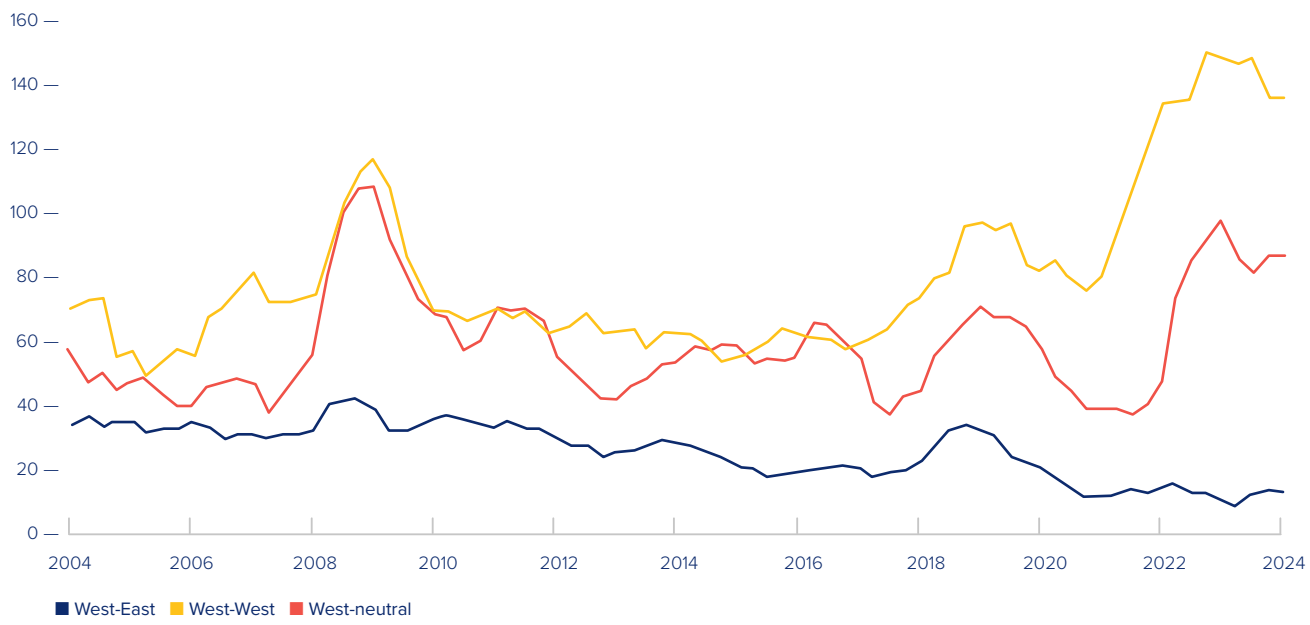
- **Artificial intelligence**
- **Batteries**
- **Critical materials**
- **Defense-related technologies**
- **ICT and cloud technologies**
- **Pharmaceuticals**
- **Semiconductors**

three times more than Asia-Pacific affiliates to U.S. GDP. Corporate Europe's footprint in the U.S., measured in terms of assets, is as large as that of firms from the entire rest of the world.

U.S. affiliate output in the Asia-Pacific region of $471 billion in 2022, the last year of available BEA data, was slightly less than U.S. affiliate output in the EU of $475 billion (29% of the global total), and 63% less than U.S. affiliate output of $770 billion in Europe broadly defined. U.S. foreign affiliate sales in Europe are a third higher than in the Asia-Pacific and more than double sales in Canada and Mexico. European foreign affiliate sales in the U.S. are double U.S. sales by Asia-Pacific firms and over five times more than U.S. sales of Canadian and Mexican firms.

U.S. companies earn more money in Europe, and European companies earn more money in the United States than either do in the rest of the world. They also invest more R&D in each other's markets than they do in the rest of the world. The transatlantic digital seaway is twice as busy as transpacific routes and four times busier than U.S.-Latin American routes. The United States is Europe's most important supplier of crude oil and liquefied natural gas (LNG), and its second largest supplier of coal. Europe has become America's most important export market for each of these three commodities.

Table 5. Global Greenfield FDI Flows (Four-Quarter Moving Averages, $Billions)



Source: Lukas Boeckelmann, Isabella Moder, Tajda Spital, "A new index to measure geopolitical fragmentation in global greenfield foreign direct investment," CEPR/VoxEU, November 15, 2024, https://cepr.org/voxeu/columns/new-index-measure-geopolitical-fragmentation-global-greenfield-foreign-direct, drawing on fDi Markets, NL Analytics and ECB staff calculations.
Through first quarter of 2024. Left: index Q1 2019 = 100; right: incidence of "shoring" terms.

Despite headlines blaring that the U.S. and Europe are drifting apart, transatlantic commercial connections are actually growing further. U.S. and European firms are turning to each other's markets to "derisk" their commercial dependencies on China, Russia and other geopolitically distant countries. The U.S. and the EU are trading more with each other and trading less with China. Greenfield FDI flows within the West are rising; those between the East and West are falling.[15] These trends could continue as geopolitical disruptions redraw global commercial flows. Boston Consulting Group (BCG) projects that by the end of 2033 U.S.-China goods trade could fall $159 billion from its 2023 level. EU-China goods trade could largely stagnate, growing by just $11 billion. BCG forecasts that U.S.-EU goods trade will grow much faster, by $303 billion.[16]

Europe and North America are constituent parts of a densely intertwined $9.5 trillion transatlantic economy. Our companies not only profit from those interconnections, they use the transatlantic economy as a common geoeconomic base that gives them an edge in a more competitive world. Our societies prosper as a result. Inevitable transatlantic disputes should not distract us from the fact that ours is the most reciprocal relationship in the world. Divorce is something we literally cannot afford.

Despite headlines blaring that the U.S. and Europe are drifting apart, transatlantic commercial connections are actually growing further. U.S. and European firms are turning to each other's markets to "derisk" their commercial dependencies on China, Russia and other geopolitically distant countries.

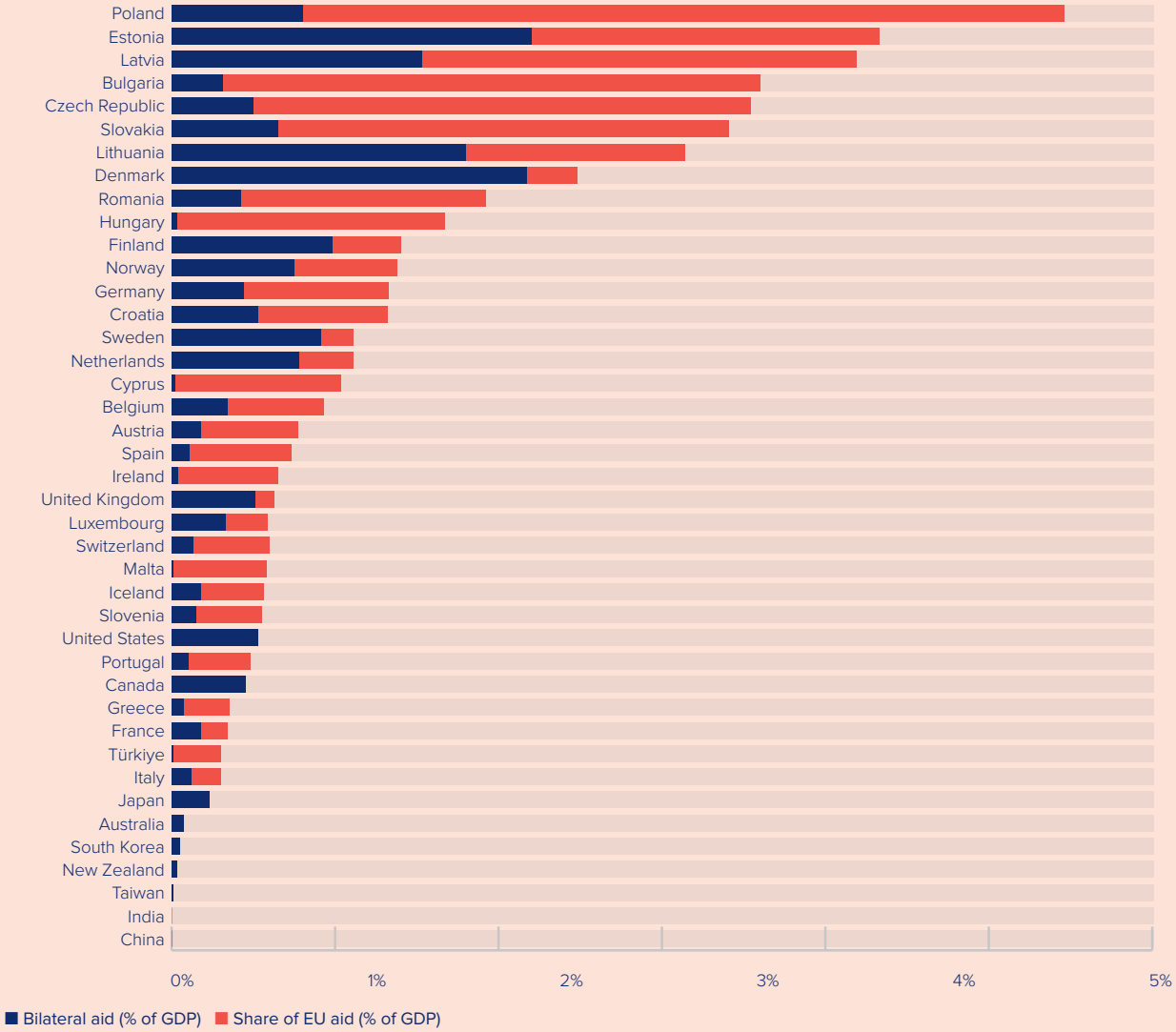
Box 1. Supporting Ukraine

Russia's ongoing aggression against Ukraine has not only devastated Ukraine and resulted in over a million people dead or injured, it has amplified global financial instabilities and supply chain distortions, wreaked havoc on food and energy markets, and generated the largest refugee crisis since World War II.

Over the past three years of full-scale war, governments from around the world have provided more than $289 billion to support Ukraine, according to the Kiel Institute for the World Economy.[17] 90% of that support has come from Europe and the United States. Between February 2022 and December 2024, Europe allocated $138 billion and the United States $123 billion in combined military, financial and humanitarian assistance to Ukraine. Of that total, the U.S. provided $69 billion in military aid and $54 billion in financial and humanitarian assistance. Europe allocated $67 billion in military aid and $76 billion in financial and humanitarian assistance.

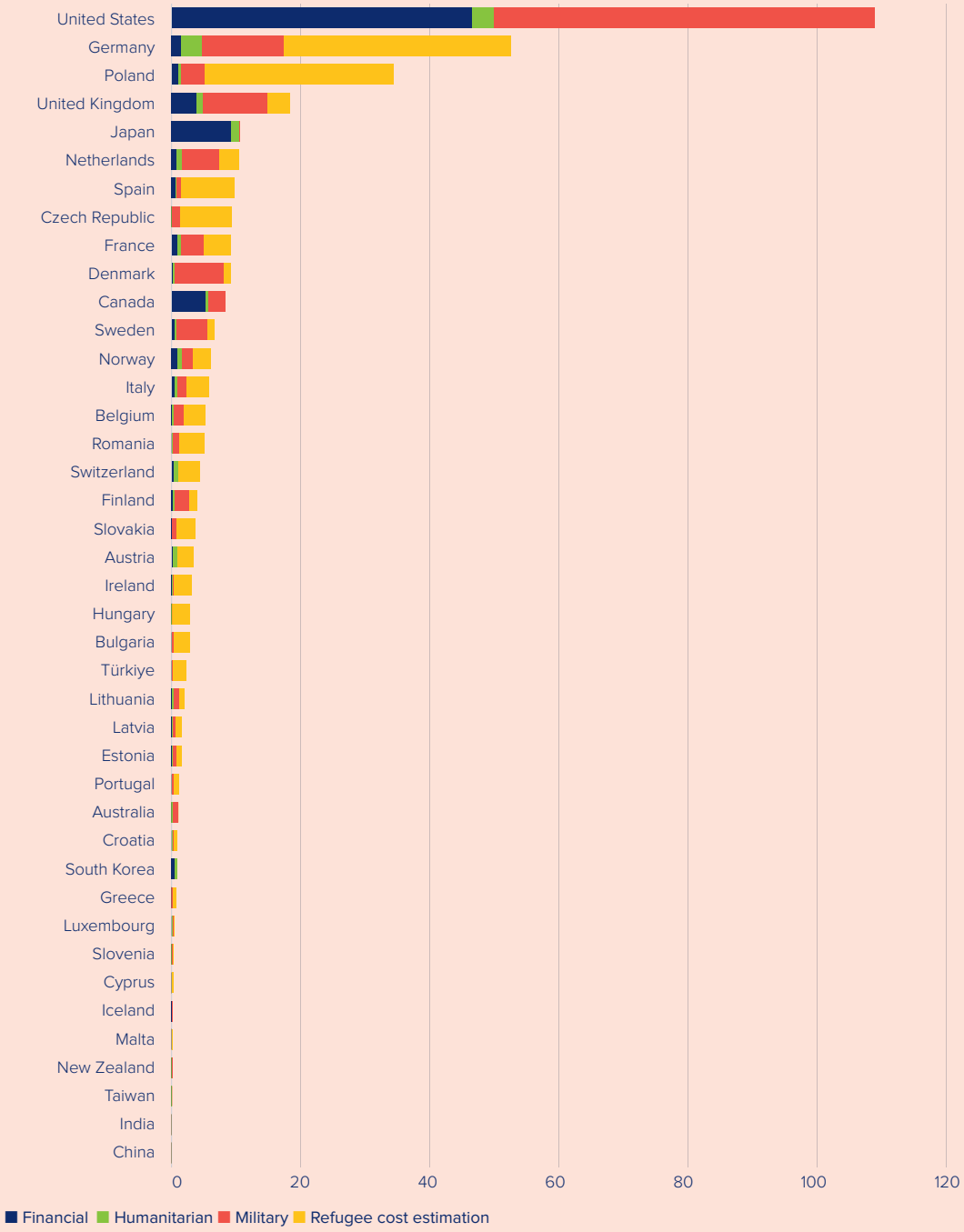
Table 6 shows support by share of donor country GDP. The top three are Poland, Estonia, and Latvia. Table 7 shows the top donors to Ukraine when refugee costs are added to bilateral support levels. The top three donors are the United States, Germany, and Poland.

Table 6 Donors to Ukraine By Share of GDP, January 2022 to January 2024



Commitments Jan. 24, 2022 to Jan. 15, 2024.
Source: The Ukraine Support Tracker, Kiel Institute for the World Economy, https://www.ifw-kiel.de/topics/war-against-ukraine/ukraine-support-tracker/.

Table 7. Donors to Ukraine: Total Bilateral Commitments Plus Refugee Costs, January 2022 to December 2024 (€Billions)



Commitments Jan. 24, 2022 to Jan. 15, 2024. Exchange rate: EUR 1 = USD 1.08.
Source: The Ukraine Support Tracker, Kiel Institute for the World Economy, https://www.ifw-kiel.de/topics/war-against-ukraine/ukraine-support-tracker/.

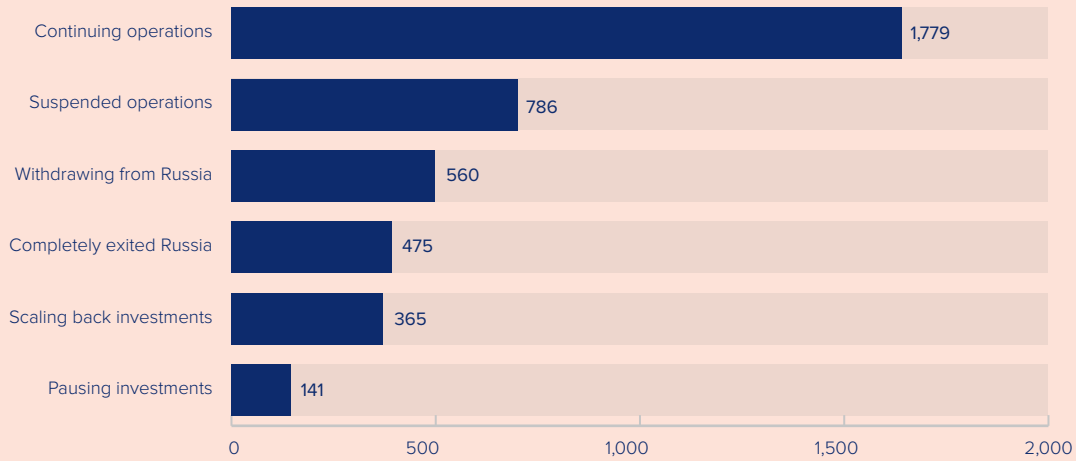
Box 2. Sanctioning Russia

North America and Europe have imposed thousands of sanctions on Russian or Russia-related individuals, entities and assets since Moscow's full-scale invasion of Ukraine in February 2022. The sanctions, unprecedented in scope and scale, encompass over 15,000 designations against individuals, entities, and assets. Much of the Russian financial sector has been disconnected from the SWIFT payments network. Exports of high-tech components and other materials critical to the Russian economy have been blocked, as have flights, shipping, maintenance, and insurance services. The G7 has banned imports of Russian non-industrial diamonds, another important source of revenue. More than $300 billion of Russian central bank assets and $22 billion of Russian oligarch money have been frozen. G7 countries agreed to provide Kyiv with at least $50 billion in returns earned from Russian assets. Foreign investment has dried up. Broadcasting activities and licenses of several Kremlin-backed disinformation outlets have been banned in many countries. Additional sanctions have been imposed on Belarus, for its involvement in Russia's invasion, and on Iran over the supply of drones to Russia. Notably, the sanctions do not block the export of and transactions related to food and agricultural products.

Following the February 2022 invasion, more than 1,000 foreign companies announced plans to leave Russia. Data from the Kyiv School of Economics reveals a more complicated picture. As of February 2025, over 1,000 companies have withdrawn or exited Russia completely. 927 have paused or suspended operations, while 365 have scaled back. 1,779 companies are continuing their activities. Many familiar brands have left the country; most that are left are smaller companies. Those seeking to withdraw are finding it difficult. Moscow is demanding that they pay a 15% "exit tax" and sell their holdings in rubles at a 50% discount.[18] Those companies that continue to do business in Russia are contributing billions in tax revenue to the Kremlin.[19]

In the critical energy field, the U.S. banned all imports of Russian oil, LNG and coal, the EU banned imports of Russian coal and other solid fossil fuels, crude oil, and refined petroleum products, with limited exceptions, and the G7 instituted a price cap on Russian oil. The U.S. and the EU have blacklisted oil and gas tankers helping Moscow earn billions from illicit fossil fuel sales. In November 2024, the U.S. sanctioned Russia's state-owned Gazprombank, the main conduit for Russian energy payments. Sanctions have been extended to additional oil producers,

Table 8. How Foreign Companies Are Changing Their Relationships with Russia (Number of Companies)



As of February 2025. Source: "Leave Russia," Kyiv School of Economics Institute, February 27, 2025, https://www.leave-russia.org.

energy traders, oilfield service providers, senior officials of state-run nuclear energy company Rosatom, and foreign organizations supporting Russia's oil exports. Kyiv's decision to end its gas transit arrangement with Moscow is likely to cost Russia $6.5 billion annually unless it redirects the flows to other pipelines or LNG importers.[20]

Impact on Russia

Russia's economy has felt the squeeze. Hundreds of billions in private capital have left the country. The ruble has slid in value. The Russian central bank projects 0.5 - 1.5% GDP growth in 2025. Inflation has spiraled to 9.5%, a 22-year high. Independent analysts believe growth is stagnant and inflation is closer to 16%. The central bank has raised benchmark interest rates to 21%, the highest in two decades. Defense and security spending will hit 8% of Russia's GDP in 2025, a post-Cold-War high. Despite enormous expenditures by the government to finance the war, overall economic growth is slowing. Many products and parts are either unavailable, more expensive, or replaced by substandard substitutes. Tightened Western energy sanctions will further undermine Russia's oil revenues and increase its energy costs by upwards of billions per month.[21]

In other respects, however, the Russian economy has weathered the situation better than expected. Russian companies have evaded the sanctions via various workarounds. China has stepped in to become Russia's biggest energy customer, an important source of finance, and a critical supplier of much-needed items, including military-related technologies and equipment. It is estimated that up to $3 billion in prohibited Western exports finds its way to Russia every month. EU companies are still buying significant amounts of Russian LNG. Russia's total imports of sanctioned goods has not decreased relative to non-sanctioned products due to trade with non-sanctioning countries. Russian exports have suffered more. Nevertheless, while exports to sanctioning countries fell by 80%, exports to non-sanctioning states increased by 40%.[22]

As time wears on, Russian prospects look much bleaker. EU sanctions lead David O'Sullivan describes Western efforts as a "slow puncture" of the Russian economy. Russian Central Bank Elvira Nabiullina has acknowledged that the economy "might go fast, but not for long."[23]

Notes

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13 European Commission, "EU trade relations with China," https://policy.trade.ec.europa.eu/eu-trade-relationships-country-and-region/countries-and-regions/china_en.

14 In previous surveys we have discussed at length the role of holding companies and so-called "phantom" FDI. We refer the reader to those surveys for a deeper understanding. The basic conclusion from this work: Europe still accounts for over half of U.S. FDI outflows even when flows from holding companies are removed from the aggregate.

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