Current account surpluses, capital flows, and the challenge of raising investment in the European Union

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Abstract

This paper explores the EU's investment landscape, emphasizing the contrast between its 3 percent of GDP current account surplus—implying significant external investment of EU savings—and its 3-4 percent of GDP internal investment gaps, especially in green and digital transitions and defence. Analysis of foreign direct and portfolio investments shows a gradual shift in investment focus away from the EU toward the USA, which might reflect investment barriers with the EU's single market. The Letta and Draghi reports recommend reforms in completing the EU's single market, including capital markets and regulatory coherence, and fiscal policy to mobilize private savings and stimulate growth, but challenges persist in reallocating investments domestically.

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1. Introduction

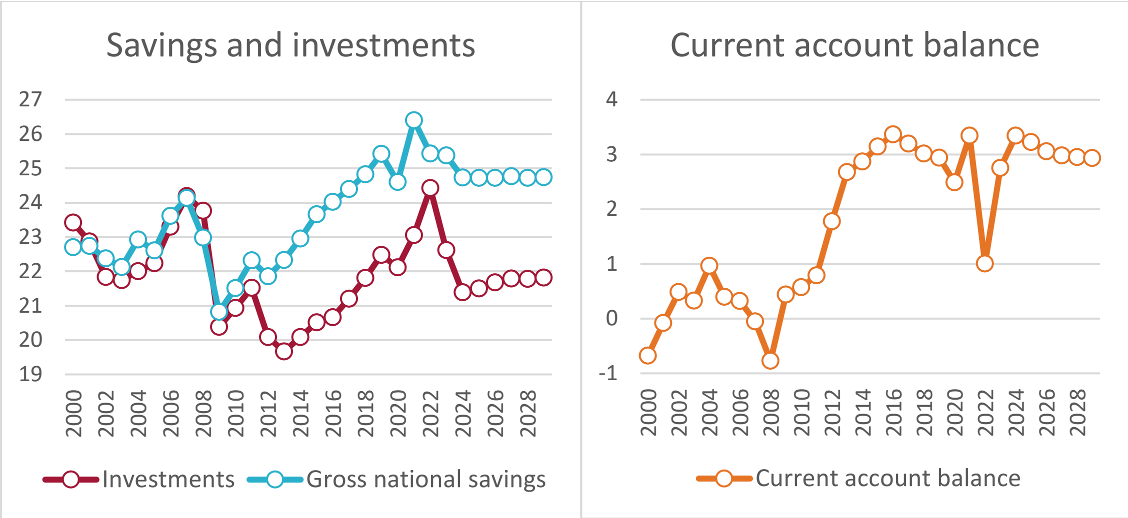
The current account balance can be interpreted from three main perspectives. First, it reflects the balance of a country or region with the rest of the world in terms of exports and imports of goods and services, factor incomes, and current transfers. A surplus, driven by exports higher than imports, indicates that a smaller portion of domestically produced goods and services is being consumed domestically relative to production. Second, it represents the balance between domestic savings and investment. A current account surplus indicates that domestic savings exceed domestic investment, leading to more domestic capital being invested abroad than is being invested domestically by foreign savers. Third, it mirrors the balance of capital flows with the rest of the world. A current account surplus signals that the country is accumulating more foreign assets than liabilities, reflecting a net lender position in global capital markets.

During the first decade of the 2000s, the European Union had a broadly balanced position in the current account despite substantial differences within EU countries. Since the early 2010s, however, the EU has maintained a persistently high current account surplus, which is projected to remain at about 3 percent of GDP in the years to come (Figure 1).

At the same time, the European Union faces a significant investment gap needed to finance the green and digital transitions. Andersson et al. (2024) compared various estimates of the EU's green investment gap. They report that according to the European Commission (2023), the EU has invested an average of €764 billion per year (equivalent to 4.8% of EU GDP in 2022) to reduce greenhouse gas (GHG) emissions on average from 2011-2020. To reach the 55% reduction target by 2030, the Commission estimates additional investment needs of €477 billion (3% of EU GDP in 2022), bringing the total annual investment needed to €1,241 billion (7.8% of EU GDP in 2022). Most of the additional investment will be required in greening the transport sector and in boosting the energy efficiency of residential real estate. The EU also suffers from an investment gap in fostering the digital transitions, as well as in other priority areas, such as defence. The Draghi report suggested an annual €750-800 billion shortfall in investment needs based on European Commission calculations, which is considered an underestimate as it excludes climate adaptation or environment protection investments. If the EU's current account surplus had been invested domestically rather than abroad, it could have covered a large portion of this gap.

According to the October 2024 World Economic Outlook (WEO) of the International Monetary Fund (IMF), domestic investment as a share of GDP in the EU is set to fall in 2024 and remain below its values observed in 2018-2023 at least until the 2029 end of the projection horizon (Figure 1). Thus, IMF forecasters do not trust that EU policies would be able to stimulate investment, and even expect an investment decline. Since savings are expected to stabilise at a higher level, the current account surplus is projected to remain persistent at around 3 percent of GDP, reaching 640 billion euros in 2029.

Figure 1 IMF projections for EU savings, investments, and current account balance (percent of EU GDP)



Source: International Monetary Fund, World Economic Outlook Database, October 2024

Note: 2024-2029 values are IMF forecasts.

Therefore, understanding the latest current account developments and the composition and dynamics of capital flows into and out of the EU is essential for analysing the reasons behind low investment levels in the EU and identifying the policy measures needed to foster the necessary investment for the twin transition.

Section 2 scrutinises EU current account developments, with a focus on countries running persistently high current account surpluses. Section 3 analyses capital flows, by analysing where EU countries invest.

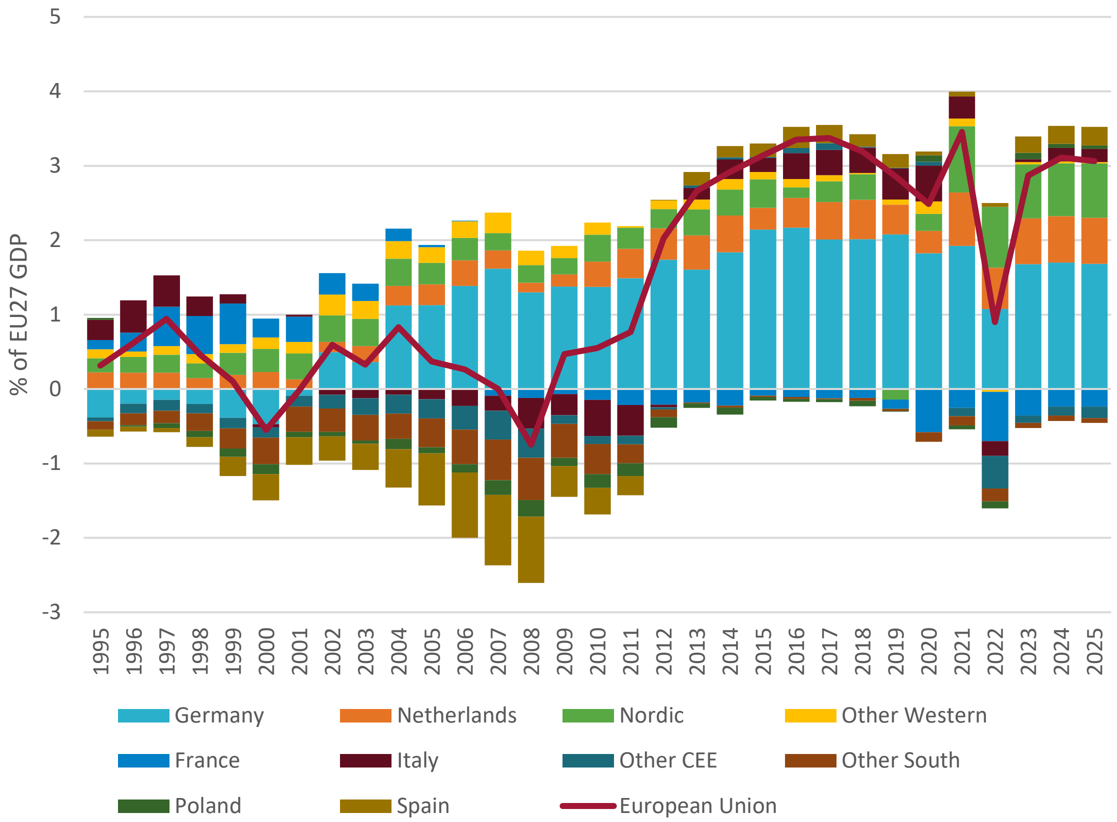
2. Current account developments

2.1 The dynamics of the European Union's current account

The EU's current account surplus is largely driven by sustained surpluses in certain member states, including Germany, the Netherlands, Denmark, and Sweden, which have maintained surpluses since at least the early 2000s (Figure 2). In contrast, the so-called "deficit countries", primarily in Eastern and Southern Europe, experienced substantial current account deficits before the 2008 global financial crisis but have since moved towards a nearly balanced position.

These pre-crisis current account deficits reflected unsustainable developments in some countries, such as credit and housing booms. Divergences in current account balances within a monetary union or an integrated economic area like the EU are not necessarily problematic. Capital flows across regions, along with resulting current account deficits and surpluses, may indicate more efficient resource allocation when capital moves to fast-growing areas, benefiting the entire economic area. However, the booms and busts in the Irish and Spanish housing markets (see Ahearne et al., 2008) illustrate instances of capital misallocation. Additionally, persistent current account deficits lead to the accumulation of external debt, which can reach excessive levels (Darvas, 2012).

Figure 2 The country-composition of the European Union's current account balance (percent of EU GDP)



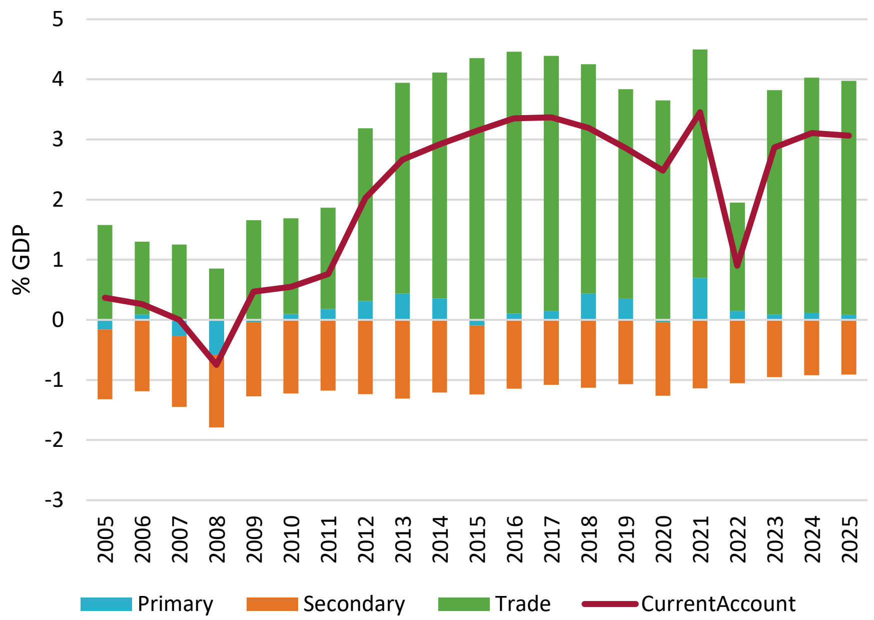
Source: European Commission's AMECO database, May 2024 version.

Note: the current 27 EU members are considered for the full 1995-2024 period. The 2024-2025 values are based on the May 2024 European Commission forecasts. Nordic: Denmark, Finland, Ireland and Sweden; other western: Austria, Belgium, Luxembourg; Other CEE: Bulgaria, Czechia, Croatia, Estonia, Hungary, Latvia, Lithuania, Slovakia, Slovenia and Romania.

The current account balance can be broken down into the balances on trade in goods and services, primary income, and secondary income (Figure 3). Primary income consists of employee compensation, investment income, and other primary income, which includes rents, taxes, and subsidies on products and production. Secondary income encompasses various transfers, such as taxes on income and wealth, social contributions, social benefits, international cooperation, insurance premiums and claims, and personal transfers between resident and non-resident households, including workers' remittances.

The breakdown of the current account into these three main components reveals that changes in the net position are primarily driven by fluctuations in the trade balance (Figure 3). The secondary income position has consistently shown a negative balance of close to one percent of GDP, with only minor variations. The primary income balance remained close to zero in most years, moving from a slightly negative position in the latter half of the 2000s to small surpluses in the 2010s.

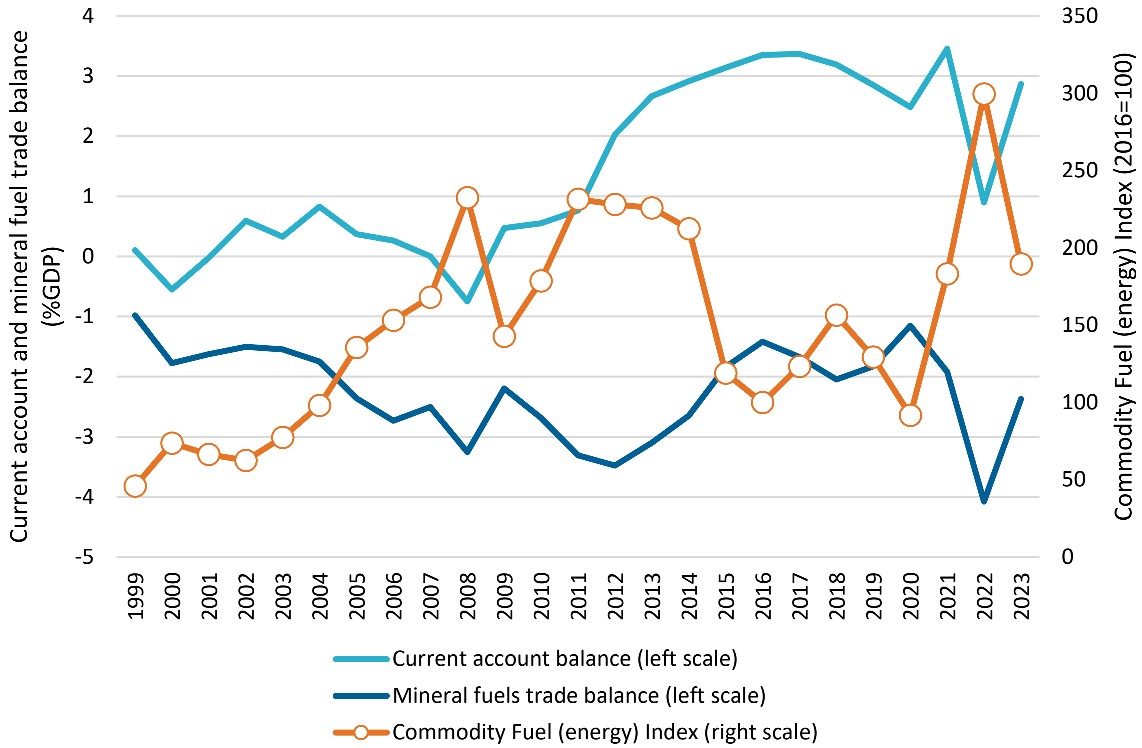
Figure 3: The flow-type composition of the European Union's current account balance (percent of EU GDP)



Source: Authors based on Eurostat's 'Balance of payments by country - annual data (BPM6) [bop_c6_a]' dataset.

Figure 3 reveals a major drop in the trade balance from 2021 to 2022 and a recovery in 2023, which was reflected in similar movements in the current account. The decline in the current account surplus was 2.6 percent of GDP – from a 3.5 percent surplus in 2021 to a 0.9 percent surplus in 2022. This coincided with Russia's full-scale invasion of Ukraine and a rapid increase in energy prices (Figure 4). While the volume of EU's energy imports decreased in 2022 due to energy efficiency measures, the price effect dominated and thus the EU's mineral fuel trade balance widened from -1.9 percent of GDP in 2021 to -4.1 percent in 2022, a drop of 2.2 percent. This drop closely aligns with the decline in the current account surplus. In 2023, as energy prices fell, the mineral fuel trade balance improved to -2.4 percent (an increase of 1.7 percent), while the current account surplus rose to 2.9 percent (an increase of 2.0 percent), again highlighting the strong direct impact of the mineral fuel trade balance on the current account balance.

Figure 4: The role of mineral fuels in the EU's current account



Source: Authors based on Eurostat's 'Balance of payments by country - annual data (BPM6) [bop_c6_a]' and 'EU trade since 1999 by SITC [ds-018995]' datasets and the October 2024 version of the IMF World Economic Outlook Dataset.

Note: The Commodity fuel (energy) index includes crude oil (petroleum), natural gas, and coal price indices.

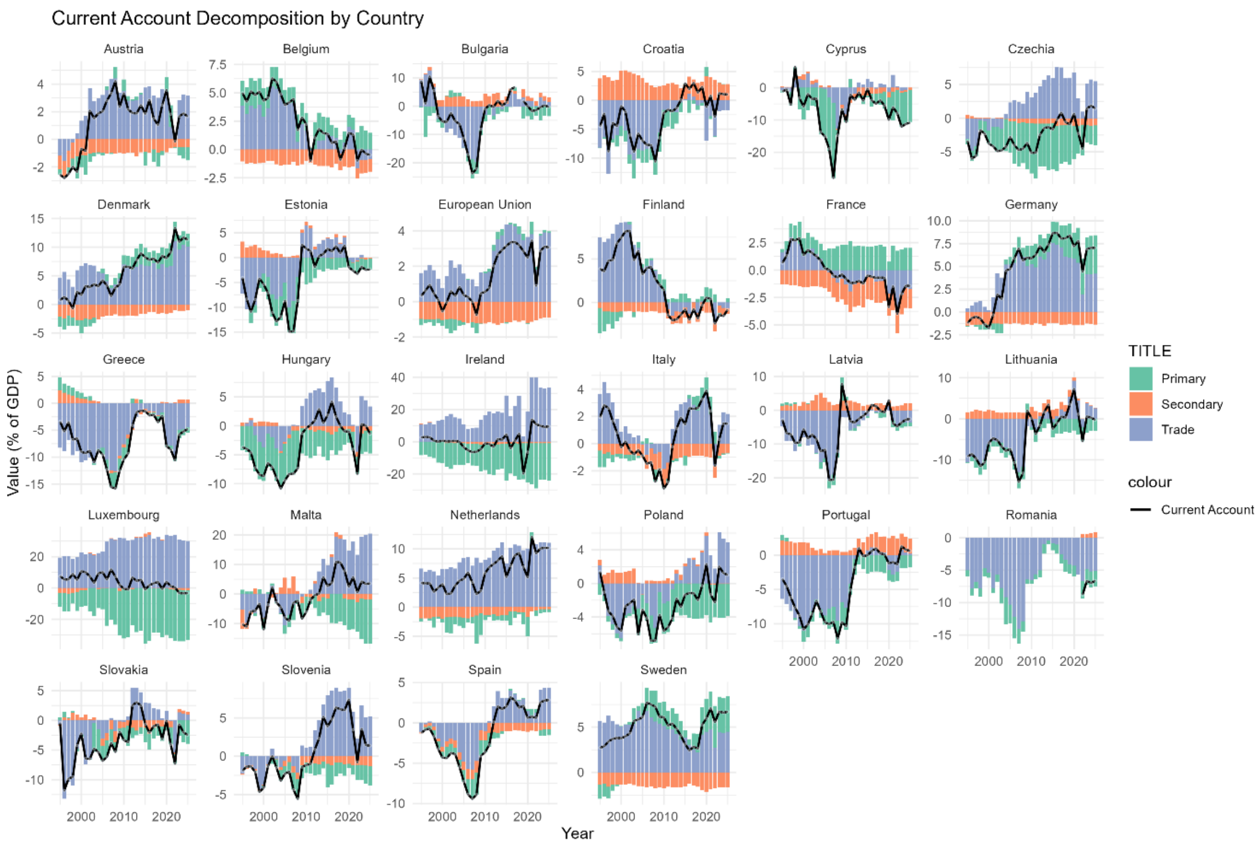
2.2 Current account developments of EU countries

Consistent with aggregate EU developments (Figure 3), the current accounts of EU countries are primarily influenced by fluctuations in the trade balance (Figure 5), especially in export-dependent countries with high surpluses, such as Germany, Denmark, the Netherlands, and Sweden. However, some of the earlier trade surpluses have diminished. For instance, Finland

and Belgium's trade surpluses of approximately 5–7 percent of GDP in the 2000s have recently shifted to a close balanced position, while France's 2.5 percent trade surplus turned into a similar-sized deficit. The substantial adjustment of large pre-global crisis trade deficits in Eastern and Southern EU countries to balanced or surplus positions is also evident; however, in some countries, such as Greece and Romania, notable trade deficits have reemerged recently.

The secondary income position is notably negative in countries with significant immigration from other EU countries and beyond—reflecting outgoing remittances—particularly in Austria, Belgium, France, Germany, Italy, and Sweden. In contrast, Croatia, Bulgaria, and Portugal recorded large inflows of secondary income, primarily due to remittances sent home by their nationals working abroad.

Figure 5: The flow-type composition of the current account balances of EU countries (percent of GDP)

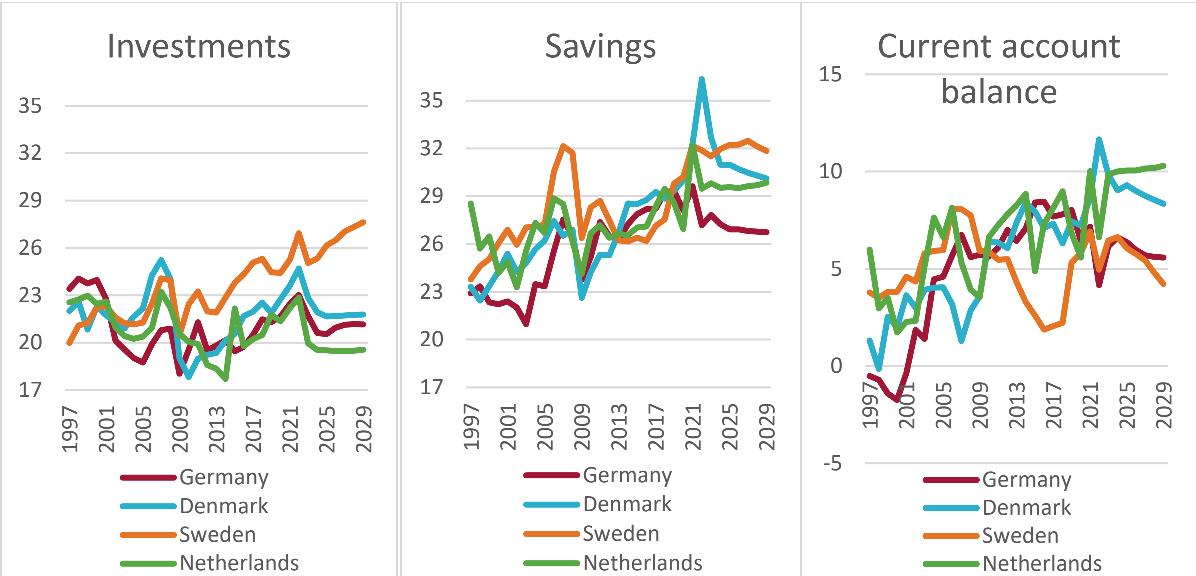


Source: Authors based on Eurostat's 'Balance of payments by country - annual data (BPM6) [bop_c6_a]' dataset.

2.3 Underlying reasons behind persistent current account surpluses in some EU countries

A key question is identifying the drivers behind persistent current account surpluses. We examine four countries in detail: Germany, the Netherlands, Sweden, and Denmark. Figure 6 presents a snapshot of investments, savings, and the current account balance in these four countries.

Figure 6: Investments, savings, and the current account balance in four countries with persistent surpluses, 1997-2029 (percent of GDP)



Source: International Monetary Fund, World Economic Outlook Database, October 2024.

Note: 2024-2029 values are IMF forecasts.

2.3.1 Germany

Researchers from institutions such as the European Commission, IMF, OECD, and academia have investigated the reasons behind Germany's large current account surplus. They generally conclude that factors which boost savings while keeping investments relatively low offer the most plausible explanations for this surplus.

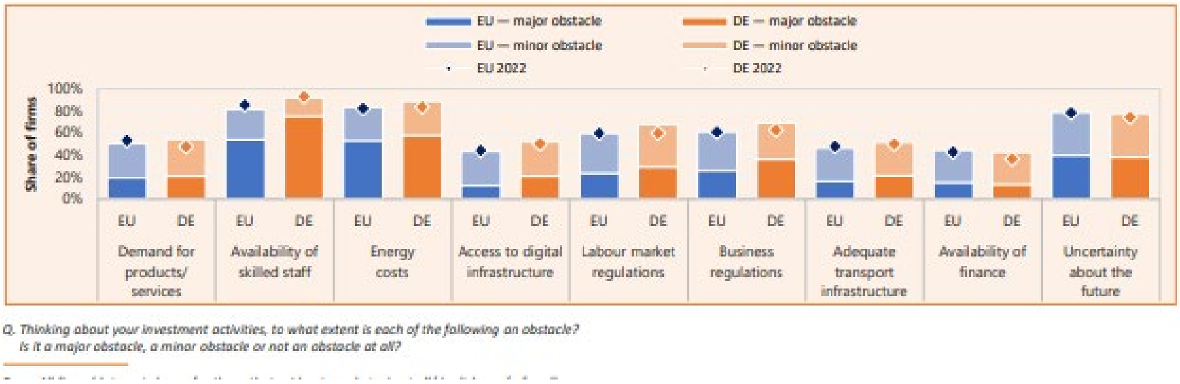
Ruppert and Stähler (2022) argue that population aging, along with various tax, labor market, and pension reforms, has led to an increase in the household savings rate in Germany. Additionally, Klug et al. (2022) identify excessive corporate savings—termed the "corporate savings glut"—as a significant driver of Germany's current account surplus.

The corporate savings glut partly stems from low investment levels, with various studies highlighting barriers to investment:

- **Lack of incentives.** Germany's declining exports have discouraged spending in the manufacturing sector, a core component of the German economy (EC ECFIN In-Depth Review, 2023).
- **High administrative burden.** Bureaucratic bottlenecks are cited as a factor in weakened investment, especially in the construction sector (EC ECFIN In-Depth Review, 2023; OECD, 2023). Simplifying the process of business creation could further stimulate investment (IMF External Sector Report, 2024).
- **Regulatory barriers to market entry and competition.** Reduced competition limits incentives for established firms to invest (OECD, 2023).
- **Weak entrepreneurship skills.** Limited entrepreneurial activity further restricts competition, keeping investment levels low (OECD, 2023).
- **Shortages of skilled labour.** 92 percent of German firms report that a shortage of skilled workers hinders investment (European Investment Bank, 2023b), a finding confirmed by the 2023 European Semester Review. Suggested measures to increase labour supply include reducing labour taxes—especially for low-skilled workers and secondary earners—facilitating skilled migration, and enhancing education and training systems (OECD, 2023). Removing trade barriers, particularly in the services sector, could also lower prices by allowing foreign construction firms to operate in Germany and employ foreign workers.
- **Uncertainties.** Uncertainty over future conditions is seen as a barrier to investment for 77 percent of all firms and 85 percent of manufacturers (European Investment Bank, 2023b). The OECD (2023) also notes that stable prices are critical for investment in sectors with long capital lifetimes, such as construction and industry, yet prolonged uncertainty about future carbon prices limits these investment incentives.
- **Limited venture capital financing.** Many young and innovative firms face difficulties accessing growth financing, as banks remain risk-averse and lack expertise in new technologies (IMF External Sector Report, 2024; OECD, 2023). The OECD (2023) recommends increasing venture capital availability by allowing public and private pension funds and other retirement savings plans to invest a larger share of their assets in venture capital funds.

However, according to the European Investment Bank (2023b), access to finance appears to be less of an obstacle to investment overall (Figure 7).

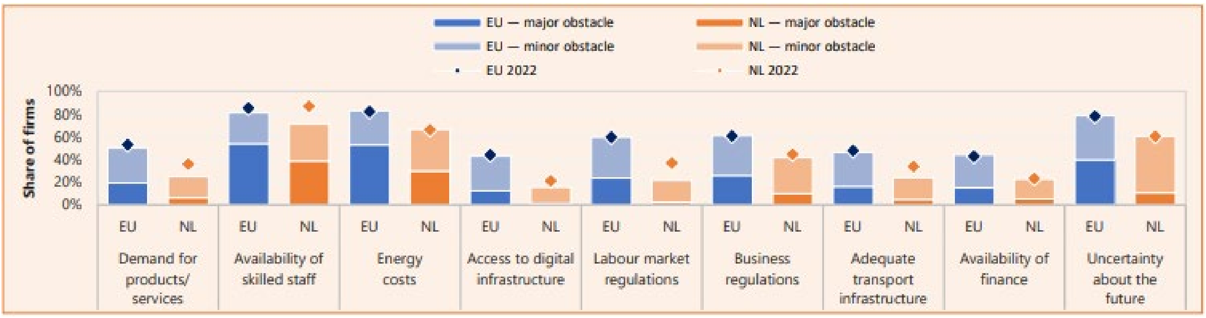
Figure 7: Survey responses on the barriers to investment in Germany



Source: European Investment Bank (2023b).

These barriers to domestic investment, along with high domestic savings, lead to a significant portion of German savings being invested abroad. The Bundesbank reports that many German firms investing internationally tend to focus on their own sectors[1]. This trend may reflect the relocation of young German enterprises to countries like the United States, where access to capital is easier and opportunities for scaling are greater.

2.3.2 The Netherlands



Source: EIB Investment Survey 2023: Netherlands (available at: https://www.eib.org/en/publications/20230340-econ-eibis-2023-netherlands)

The Netherlands has consistently maintained current account surpluses since the 1990s, primarily driven by trade (Suyker and Wagteveld, 2019). While both the primary and secondary income balances have been negative across nearly all periods—with just one exception—these negative balances have diminished in recent years, partly due to higher interest income for banks (De Nederlandsche BSank, 2023).

The Netherlands' current account surplus is largely attributed to the presence of multinational companies, which generate external transfers through foreign direct

[1] https://www.bundesbank.de/en/statistics/external-sector/direct-investments/stock-data-776576

investment (FDI), contributing to deficits in the primary income balance (IMF, 2024). Small and medium-sized enterprises (SMEs) also support these surpluses due to higher savings levels, driven by lending restrictions and tax incentives. Looking ahead, IMF (2024) anticipates that demographic changes, along with rising fiscal deficits, could lead to lower current account surpluses and a more balanced macroeconomic situation. However, the October 2024 IMF World Economic Outlook projects that the current account surplus will remain above 10 percent of GDP through the end of the forecast period in 2029.

The European Commission (2024) attributes the Netherlands' current account surpluses not only to the presence of large multinational companies but also to specific features of the Dutch tax and pension systems that promote higher savings. Additionally, the Commission highlights investment obstacles, including labor shortages and limited capacity in the electricity grid.

2.3.3 Denmark

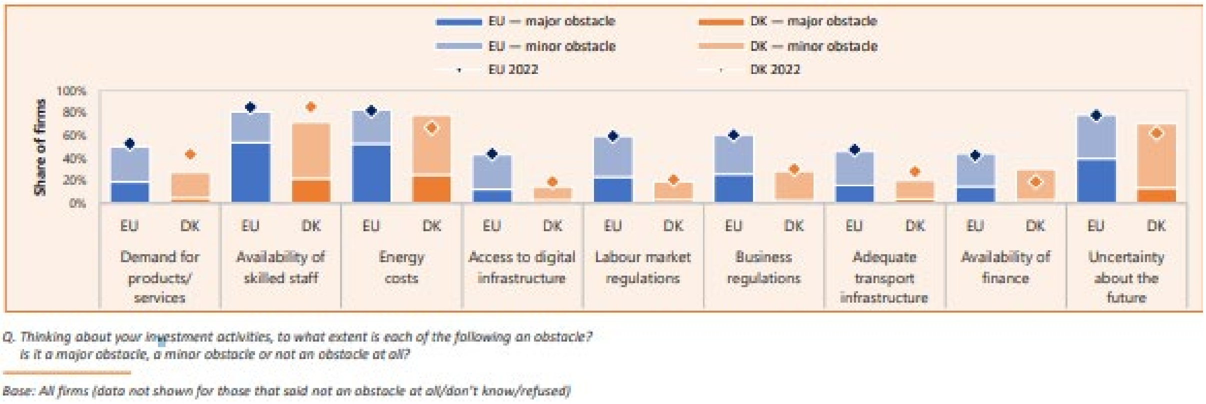
In 2022, Denmark’s current account surplus reached 13.1% of GDP, the highest in the EU. This sharp increase compared to 2021 is largely attributed to a temporary spike in sea freight rates (European Semester). However, Denmark has also seen a steady overall rise in its surplus since the 1990s. With increased FDI abroad, the primary income balance turned positive in 2005, further contributing to the surplus. Over the past three years, changes in the trade balance have gained significance once again (OECD, 2024).

Since 2005, the average yield on Denmark's foreign investments has been strong (Leszczuk and Pojar, 2016). Recent increases in FDI in the United States are largely due to investments by major Danish energy and manufacturing companies like Ørsted, Novo Nordisk, Danfoss, Vestas, and DSV, as well as acquisitions of foreign firms by Danish companies (Risbjerg and Christensen, 2022). Additionally, round-trip investments by Danish subsidiaries abroad may account for some of the substantial inflows from Europe and the United States.

The literature on the reasons for stagnant domestic investment in Denmark is inconclusive. There is no evidence that mispricing of risk or inflated return expectations drive high levels of investment abroad (Leszczuk and Pojar, 2016). Similarly, no evidence suggests that limited access to credit significantly impacts aggregate domestic investment (Leszczuk and Pojar, 2016). Denmark already has a well-funded R&D sector and a flagship green policy under its Recovery and Resilience Plan, designed to attract additional private sector investment (European Semester Report).

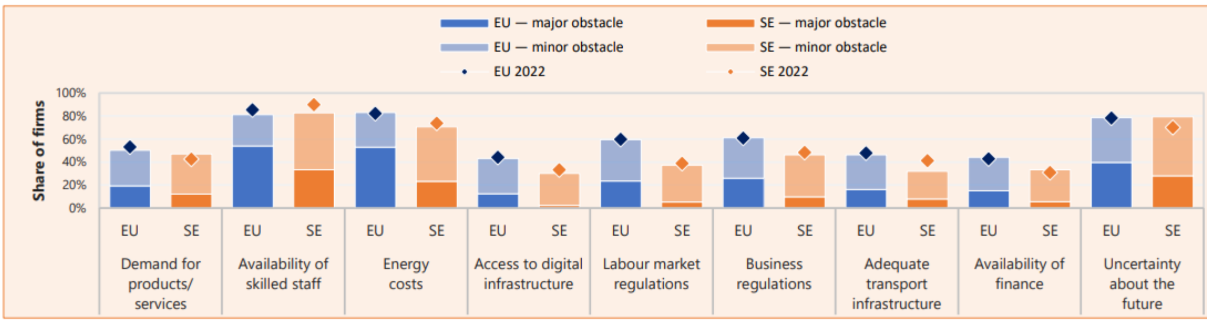
A survey by the European Investment Bank (2023a) indicates that firms identify energy costs (79 percent), skilled labour shortages (72 percent), and future uncertainty (71 percent) as the primary barriers to investment (Figure 8). However, these concerns are notably less pronounced than in other EU countries. Labour market regulations, in particular, are a significantly lower barrier in Denmark, cited by only 20 percent of firms compared to 60 percent across the EU.

Figure 8: Survey responses on the barriers to investment in Denmark



Source: European Investment Bank (2023a).

2.3.4 Sweden



Source: EIB Investment Survey 2023: Sweden (available at: https://www.eib.org/attachments/lucalli/20230340_econ_eibis_2023_sweden_en.pdf)

In contrast to the steady increase in current account surpluses observed in Germany, Denmark, and the Netherlands over the past 25 years, Sweden's current account surplus has fluctuated between 2 and 7 percent of GDP in this period. In 2023, Sweden's surplus rose to approximately 7 percent of GDP, primarily due to decreased imports amid an economic downturn and increased export levels (European Commission, 2024). The IMF has noted that this surplus exceeds levels suggested by economic fundamentals, with a similar trend seen in the financial account, which reached 3.8 percent of GDP in 2023 (IMF, 2024). The volatility of the financial account is partly attributed to Sweden's large banking sector—approximately three times its GDP—which is sensitive to shifts in portfolio investment (IMF, 2024).

Since the end of the global financial crisis, Sweden's investment ratio has consistently exceeded that of Germany, Denmark, and the Netherlands. The IMF projects that this ratio will reach nearly 28 percent of GDP by 2029, which is 6 to 9 percentage points higher than that of the other three countries (Figure 6). This indicates that low investment levels are unlikely to be the reason for Sweden's current account surplus; instead, substantial savings may be the contributing factor (Zoega, 2021). Additionally, as Sweden has accumulated an increasing amount of foreign assets, the primary income component of its current account surplus has gained significance, reaching a surplus comparable to that of the trade balance (Figure 5). In contrast, the primary income balance for the Netherlands is close to zero, while it is much smaller (as a share of GDP) for Denmark.

3. Recent dynamics and composition of gross capital outflows and inflows in EU countries

Analysing the dynamics of gross capital flows is crucial, especially as gross flows have surged over recent decades. Key considerations include the debt-equity mix, maturity structure, and currency composition of gross flows. High levels of gross capital outflows and inflows can theoretically have a stabilizing effect by facilitating international risk diversification (Lane, 2013). Specifically, foreign liabilities allow domestic risks to be shared with foreign investors, while holding foreign assets can provide some insulation for domestic investors. This risk-sharing occurs through bilateral valuation gains and losses, which vary depending on the composition and type of capital flows, particularly in terms of the instruments involved.

Darvas and Hüttl (2017) found that for several countries, valuation changes have been more substantial than current account and financial transactions. These valuation changes on net foreign assets appear to follow identifiable patterns rather than being random, playing a significant role in sustaining international investment positions both before and after the 2008 financial crisis. Specifically, countries with negative net international investment positions (NIIPs) often experienced positive revaluation gains, while countries with large net foreign assets frequently incurred revaluation losses. This trend suggests that revaluation effects can act as an adjustment mechanism, contributing to the sustainability of international investment positions.

3.1 The EU's asset and liability positions relative to non-EU countries

Table 1 presents the stock of foreign assets and liabilities held by the EU27 relative to non-EU27 countries. These stocks are determined by both transaction flows and valuation effects. From 2014 to 2023, the total stock of foreign assets rose from 185 percent of GDP to 196 percent, though there were fluctuations during this period. Meanwhile, the stock of liabilities saw a slight decrease, moving from 202 percent to 199 percent of GDP. Consequently, the EU's negative net investment position improved considerably, narrowing from -17 percent of GDP in 2014 to -2 percent in 2023. This shift aligns with the EU's ongoing current account surplus over the period, supporting a gradual reduction in its net debtor position.

Table 1: International investment position of the EU27 relative to non-EU27 countries, 2014-2023 (% EU GDP)

	FDI assets	FDI liabilities	FDI net	PI assets	PI liabilities	PI net	OI assets	OI liabilities	OI net	FD assets	FD liabilities	FD net	Total assets	Total liabilities	Total net
2014	74.4%	60.7%	13.7%	51.8%	83.6%	-31.8%	40.1%	38.9%	1.1%	18.8%	19.1%	-0.3%	185.0%	202.3%	-17.3%
2015	86.8%	71.6%	15.1%	54.9%	88.1%	-33.2%	39.5%	38.4%	1.1%	14.8%	15.0%	-0.1%	196.0%	213.1%	-17.1%
2016	89.5%	74.3%	15.2%	58.4%	85.6%	-27.2%	39.2%	40.5%	-1.4%	14.2%	14.5%	-0.3%	201.2%	214.9%	-13.7%
2017	84.3%	74.6%	9.7%	64.1%	91.3%	-27.3%	38.6%	39.8%	-1.1%	10.2%	10.5%	-0.4%	197.1%	216.2%	-19.1%
2018	80.0%	70.1%	10.0%	61.7%	84.3%	-22.6%	39.4%	41.4%	-2.0%	9.3%	9.8%	-0.5%	190.4%	205.5%	-15.1%
2019	80.1%	69.6%	10.5%	70.5%	94.3%	-23.8%	40.5%	39.6%	0.8%	11.6%	11.8%	-0.2%	202.7%	215.4%	-12.7%
2020	81.2%	72.0%	9.2%	78.4%	97.1%	-18.7%	42.4%	42.1%	0.3%	14.8%	14.9%	-0.1%	216.8%	226.1%	-9.2%
2021	80.2%	69.3%	10.9%	87.0%	100.8%	-13.8%	42.4%	43.9%	-1.5%	14.4%	14.7%	-0.3%	224.1%	228.7%	-4.6%
2022	75.2%	65.6%	9.6%	68.5%	83.3%	-14.8%	39.3%	40.8%	-1.5%	21.7%	21.5%	0.2%	204.7%	211.1%	-6.4%
2023	68.7%	58.8%	9.9%	70.8%	83.8%	-13.1%	38.3%	37.3%	1.0%	18.6%	18.6%	0.0%	196.3%	198.5%	-2.2%

Source: Bruegel based on Eurostat's 'International investment position - quarterly and annual data (BPM6) [bop_iip6_q]' and 'GDP and main components (output, expenditure and income) [nama_10_gdp]' datasets.

Note: FDI =foreign direct investment; PI=portfolio investment; OI=other investment; FD=financial derivatives.

Among the EU's foreign assets held outside the EU, foreign direct investment (FDI) and portfolio investment (PI) comprised approximately 70 percent of GDP in 2023. Other investments (OI) were slightly below 40 percent of GDP, and financial derivatives (FD) account for just under 20 percent. The primary driver of the EU's improved net investment position relative to non-EU countries has been the growth in portfolio assets, which rose by about 20 percent of GDP from 2014 to 2023. Meanwhile, the ratio of portfolio liabilities to GDP was the same in 2014 and 2023 (though with some fluctuations in between). The FDI position, both gross and net (as a share of GDP), has remained broadly stable over the past decade, and only small changes observed in other investments and financial derivatives, too.

3.2 Where do EU countries invest?

To analyse the investment destinations of EU countries, we use three datasets containing bilateral data: two from the IMF—the Coordinated Direct Investment Survey (CDIS) and the Coordinated Portfolio Investment Survey (CPIS)—and the third from the BIS's Locational Banking Statistics (LBS). Box 1 provides a summary of the main features of these datasets. These datasets provide information on the stock of assets and liabilities rather than annual flows. Since changes in stock values reflect both transaction flows and valuation adjustments—and the latter can be significant (Darvas and Hüttl, 2017)—it is not feasible to derive flow data directly from stock data.

Box 1: Brief descriptions of direct investment, portfolio investment and banking statistical data.

IMF Coordinated Direct Investment Survey (CDIS)

This dataset provides cross-border data for IMF countries, including all EU countries, covering the period from 2009 to 2022. We use the variables 'Inward/Outward Direct Investment Positions, Derived, US Dollars.' Some observations in the dataset are classified as confidential and are therefore excluded from our analysis. Country aggregates do not include NA values.

IMF Coordinated Portfolio Investment Survey (CPIS)

This dataset covers cross-border data for IMF countries, including all EU countries, from 2001 to 2023. We utilize the variables 'Assets/Liabilities, Total Investment.' Some observations in the dataset are classified as confidential and therefore cannot be included in our analysis. Country aggregates do not include NA values.

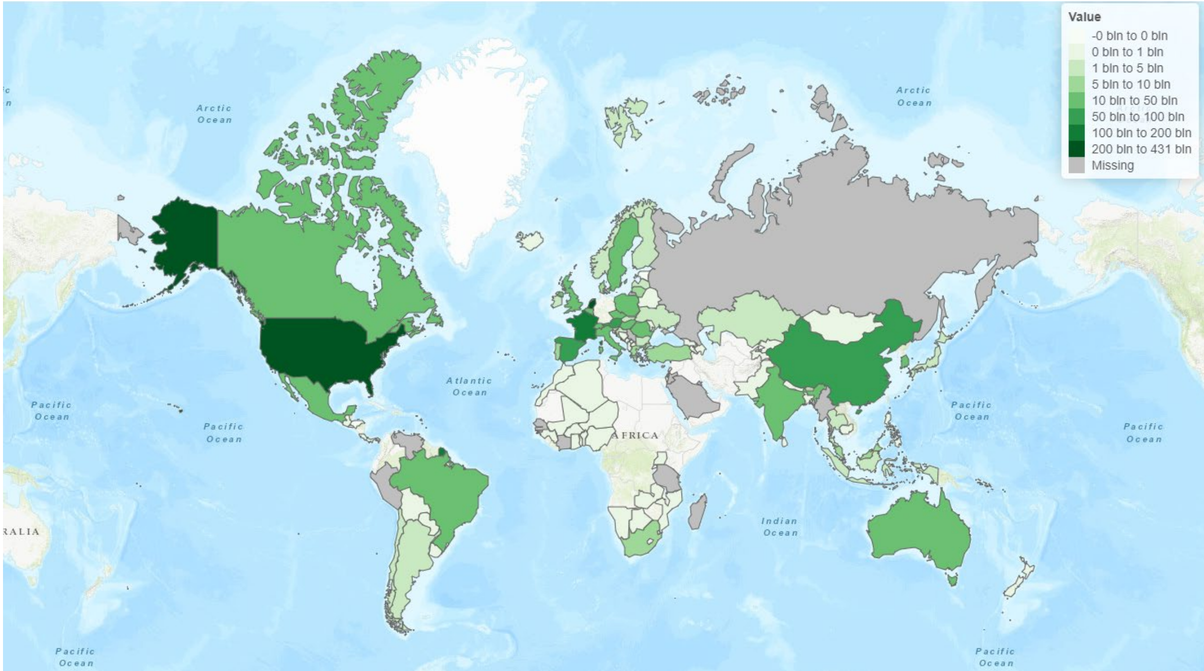
BIS Locational Banking Statistics (LBS)

We use this dataset for banking stock position statistics. It covers cross-border data from 2000 to 2023 for a large sample of reporting countries, including 15 EU countries. The EU countries included in the dataset are Greece, Luxembourg, Portugal, Austria, Cyprus, Ireland, Germany, Denmark, Belgium, Sweden, Italy, Spain, Finland, France, and the Netherlands. We utilize the values for claims and liabilities included in the dataset. Some observations are classified as confidential, so we cannot include them in our analysis. Country aggregates do not include NA values.

German foreign direct investments are distributed globally (see Map 1). Grouping destination countries, we find that the largest portion, totaling USD 1,079 billion out of the total USD 1,885 billion (implying a 57 percent share) in 2022, was invested in other EU countries, with Austria, France, Italy, Poland, and Spain being notable recipients. Investments in the U.S. reached USD 401 billion, while USD 120 billion was directed to other advanced economies, including the UK. Among BICS countries (Brazil, India, China, and South Africa—Russia data is unavailable), investments amounted to USD 136 billion, with an additional USD 33 billion in other Asian countries and USD 85 billion in the rest of the world. Consequently, Germany's foreign investments predominantly target advanced economies, particularly within the EU and the U.S.

German FDI liabilities are primarily concentrated in other EU countries, totaling USD 861 billion. The U.S. ranks second with USD 190 billion, followed by other advanced economies with USD 175 billion. The BICS countries (Brazil, India, China, and South Africa) hold relatively modest FDI claims on Germany at USD 22 billion, while other Asian countries account for USD 1.5 billion, and the rest of the world holds USD 15 billion. This indicates that FDI connections are much stronger among advanced economies, with China and other emerging markets playing a comparatively minor role in Germany's FDI landscape.

Map 1: Germany’s FDI assests held abroad, 2022

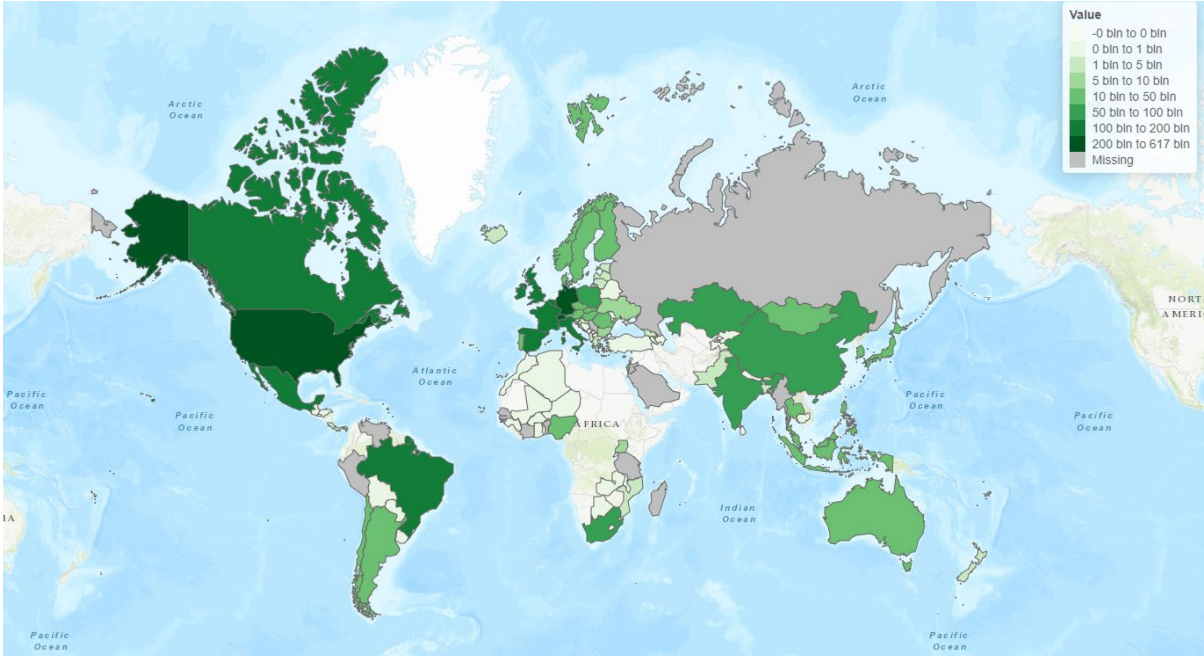


Source: Bruegel based on the IMF’s Coordinated Direct Investment Survey

The USD value of both FDI assets and liabilities in the Netherlands exceeds that of Germany by more than double, despite the Dutch economy being only a quarter the size of Germany's. This significant discrepancy highlights the Netherlands’ role as a financial center, often described as a tax haven that intermediates substantial capital flows. For instance, Garcia-Bernardo et al. (2017) identified the Netherlands as one of the five major “*conduit offshore financial centers*”, which are attractive intermediate destinations for routing international investments and facilitating capital transfers without taxation.

The Dutch FDI position is more diversified than that of Germany (Map 2). For instance, while Germany held 57 percent of its FDI assets in other EU countries, this share is significantly lower at 40 percent for the Netherlands (USD 1,460 billion out of a total of USD 3,664 billion) in 2022. The share of FDI assets in the US is also lower for the Netherlands at 17 percent compared to 23 percent for Germany. Conversely, the shares of other regions are higher for the Netherlands: other advanced countries account for 20 percent of Dutch FDI assets, compared to just 5 percent for Germany. Additionally, the combined share of BICS and other Asian countries represents 12 percent for the Netherlands and 9 percent for Germany.

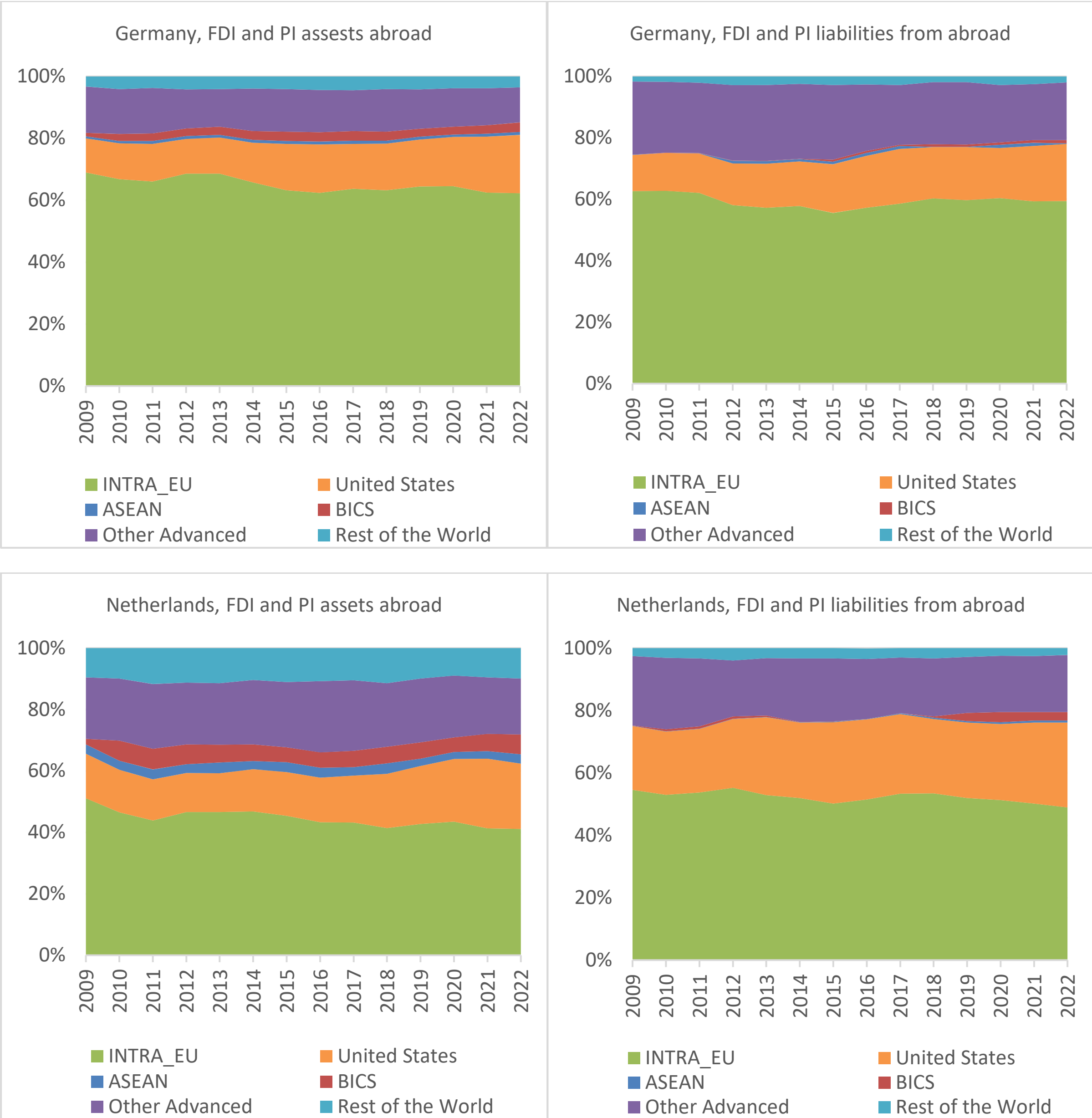
Map 2: The Netherland's FDI assests held abroad, 2022

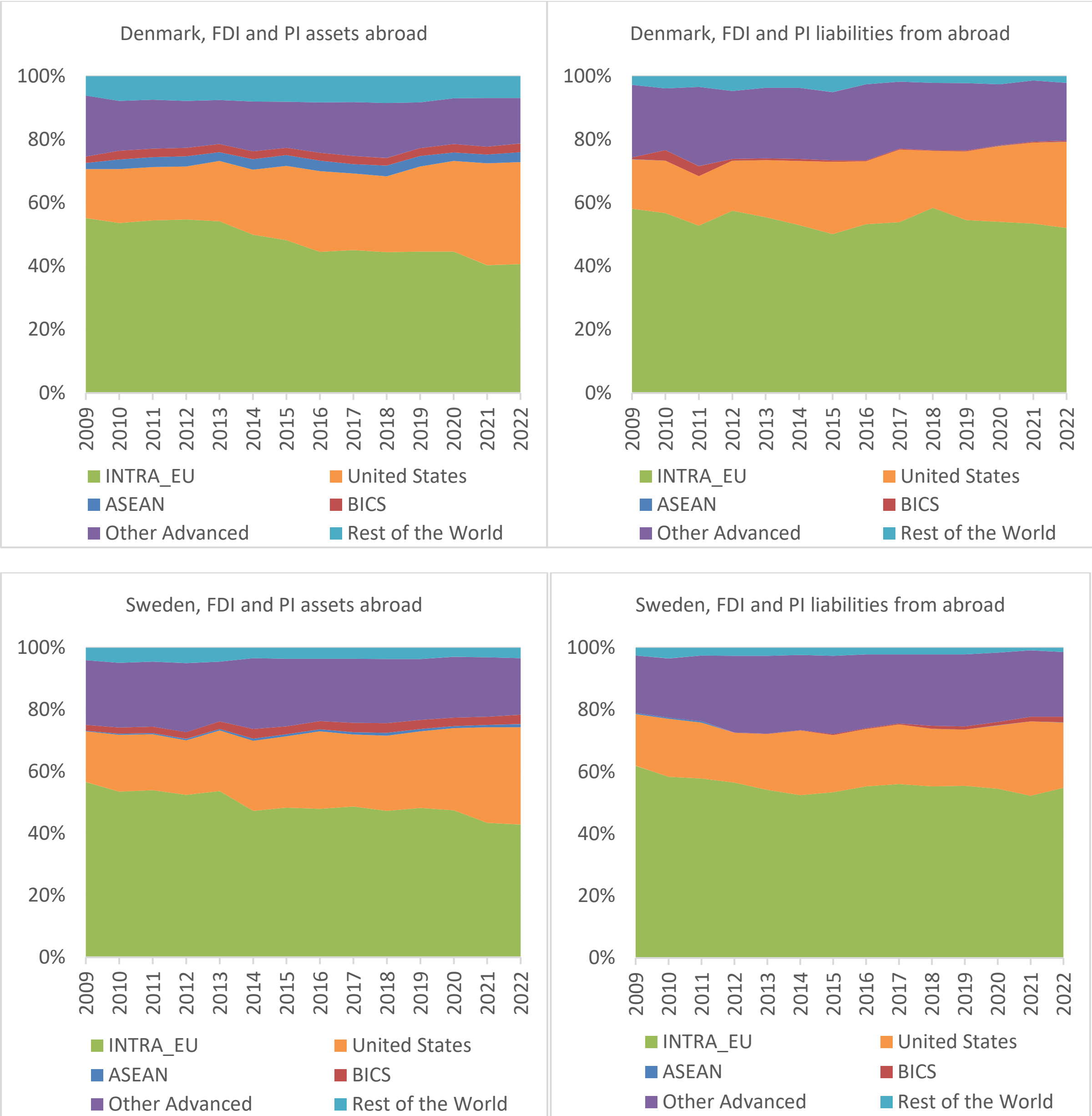


Source: Bruegel based on the IMF's Coordinated Direct Investment Survey

Figure 9 illustrates the annual developments of Foreign Direct Investment (FDI) and Portfolio Investment (PI) positions, showing how these investment types have evolved year-over-year. This visualization provides insights into trends and fluctuations, helping to highlight differences in the growth rates, volatility, and any potential shifts in investment strategies across the periods observed.

Figure 9: The geographical composition of FDI plus PI assets and liabilities of four EU countries with large current account surpluses (% of total)





Source: Bruegel based in the IMF's Coordinated Direct Investment Survey and Coordinated Portfolio Investment Survey.

Germany invests a larger portion of its foreign assets within the EU compared to the Netherlands, Denmark, and Sweden. Among the Nordic countries, Denmark and Sweden allocate substantial investments to other Nordic nations and the USA, with relatively little directed to other parts of Europe. The USA stands as the most significant non-EU investment partner for all four countries, and the narrowing gap between the EU and the USA in their outward capital positions indicates a gradual shift in investment focus from the EU to the USA.

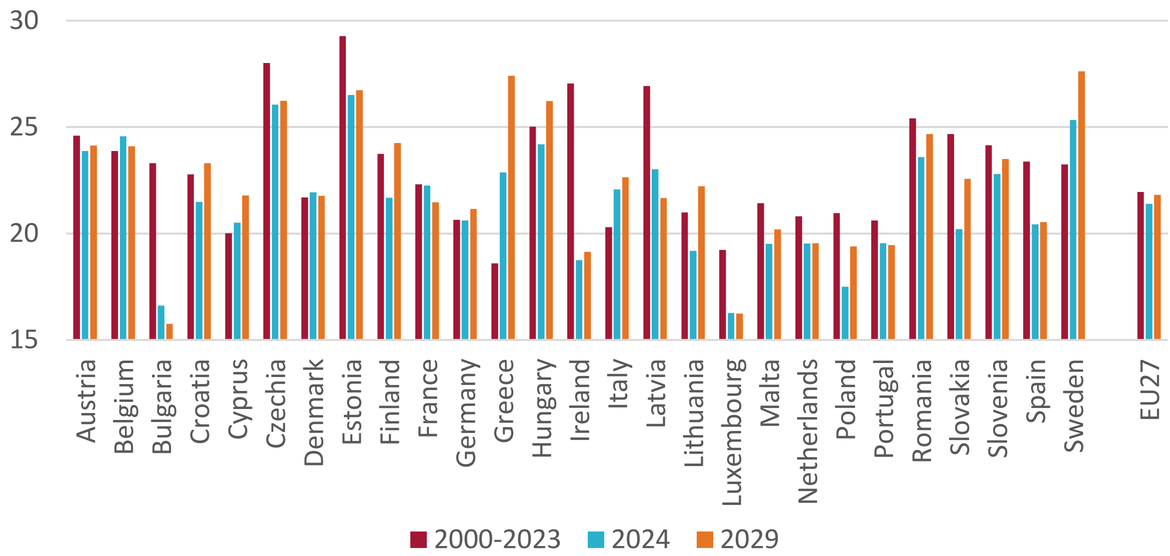
Ireland uniquely diverges from other EU countries with the USA representing a more important investment destination than the rest of the EU. This likely stems from Ireland's role in hosting major multinational corporations and its classification as one of the five main conduit offshore financial centres, as concluded by Garcia-Bernardo et al. (2017).

Meanwhile, investments in BICS and other Asian regions remain relatively low for all EU countries, indicating limited exposure in these regions.

4. Options to foster investments in the EU

Investment rates vary widely across the EU (Figure 10). The 2024 forecasts range from less than 17 percent of GDP in Luxembourg and Bulgaria to more than 26 percent in Estonia and Czechia. The October 2024 IMF World Economic Outlook expects that this range will widen even further by 2029, with projections of less than 16 percent in Bulgaria and more than 27 percent in Sweden and Greece. Overall, the investment rate in the EU from 2024 to 2029 is projected by the IMF to remain below its average value from 2000 to 2023, despite significant investment gaps in green, digital, and defence sectors.

Figure 10: Investment rates in EU countries (% GDP)



Source: IMF World Economic Outlook, October 2024 version.

Note: Gross capital formation is reported, which is the total value of the gross fixed capital formation and changes in inventories and acquisitions less disposals of valuables for a unit or sector.

Two recent reports have been prepared at the request of the European Council and the European Commission, both focusing on how to foster investments in the EU: the Letta Report from April 2024 (Letta, 2024) and the Draghi Report from September 2024 (Draghi, 2024). These reports complement each other and provide valuable ideas for both EU and national policymakers.

4.1 The Letta report

The main premise of the Letta Report is that higher levels of investment are essential to achieving key EU goals related to the twin green and digital transitions, as well as defence. Given that the EU's single market remains fragmented along national borders, hindering cross-border activities, the report emphasizes the need to complete the EU's single market. Both private and public funds must be channelled toward these objectives.

Central to Letta's vision is the addition of a fifth freedom to the existing four[2], which involves enhancing research, innovation, and education in the EU's single market. He emphasizes the urgency of supporting European businesses in their global competition and advocates for streamlined regulations with consistent enforcement. The report also offers insights on enlargement, security, and social cohesion, providing a roadmap for revitalizing the Single Market while upholding European values in the 21st century.

Private sector measures

The report emphasizes the need to create a 'Savings and Investments Union' to unlock the potential of the Single Market. It highlights the important role of underdeveloped EU capital markets, noting that the EU's share in various capital market indicators is significantly lower than its share of global GDP. This issue is illustrated by the fact that one-third of the current €33 trillion in private savings is held in bank deposits. While these savings are channelled into the economy through banks, the banks' risk-averse nature often limits access to finance for young and innovative firms. To address these challenges, the report proposes reforms that consider both the demand and supply sides, as well as the existing institutional and market structures.

The report puts forward various concrete proposals, including:

- Developing an EU long-term savings product with an auto-enrolment system to allow for a transnational pension product.
- Increasing coherence among individual country frameworks, for instance, through the convergence of supervisory institutions.
- Strengthening financial literacy.
- Establishing an EU-wide scheme to channel retail savings into investments.

[2] The European Union's four economic freedoms are the free movements of goods, services, labour, and capital.

- Providing public sector guarantees similar to those in the Juncker Plan, to be implemented by the European Commission and the EIB.
- Promoting Public-Private Partnerships (PPPs).
- Enhancing accessibility and effectiveness through new frameworks for securitization.
- Establishing an EU stock exchange for deep tech companies. These capital-intensive firms face higher risks, as evidenced by elevated bankruptcy rates, but they can offer long-term returns on investment and scalability if successful.
- Harmonizing insolvency regimes.
- Implementing a digital euro before 2027.

Public sector measures

Regarding public funds, reforming state aid is essential to safeguard a level playing field within the single market. In the short term, the report proposes reforming the current system while creating a future framework that provides European institutions with fiscal capacity. The concrete proposals include:

- Reforming state aid to ensure a level playing field.
- Establishing European public investments with common policy goals and conditionality to guarantee the effective use of funds.
- Addressing inequalities in technical and administrative capacities among countries.
- Increasing competition in public procurement.
- Setting up a facility for a Pact enhancing European Administrations Cooperation and Expertise (PEACE), which should boost both investments and reforms of public administrations.

The report however does not provide a specific timeline for the implementation of its recommendations. The Draghi report has partially filled this gap as it does provide this specific time component to the assessment.

While being successful in touching the different priorities and also suggesting specific policies to reinvigorate the reforms of the single market, the report overall lacks the quantitative component that can make it more robust. Focusing on the investments and savings union, the report does not help in facing the trade-offs that the recommended policies would entail. It does not clarify some other aspects as well, such as whether there is a need for further savings or not (Berg and Meyers, 2024). It is nevertheless true that the main point of the report was to switch on the debate and set priorities rather than offer quantitative research (Zettelmeyer, 2024a).

In summary, the report clearly sets the policy priorities needed for the EU single market and has been successful on reinvigorating the political debate. The following steps to the report should be adding further specificity on how and when to implement these measures. As we discuss in the following section, this task has been partially fulfilled by Draghi (2024).

4.2 The Draghi report

The Draghi report, a detailed 500-page document including annexes, provides an in-depth analysis of the EU's competitiveness challenges and outlines numerous proposals to address them. It identifies an annual EU investment gap of around EUR 800 billion, equivalent to 4.7 percent of the EU's 2023 GDP, and proposes substantial reforms and investments to bridge this gap. Part of this funding would be secured through EU-issued common debt.

The report recommends several key strategies: revamping the EU's innovation and competition policy (Scott Morton, 2024), reducing fragmentation in capital markets, delegating more tasks to the EU level where efficient, and prioritizing the EU budget toward EU-level public goods (Buti and Messori, 2024). It also aims to reconcile EU decarbonization targets with industrial competitiveness (Tagliapietra, 2024) and includes practical proposals for reducing energy system costs (Zachman, 2024).

However, the report has faced various criticisms. Zettelmeyer (2024b) expressed concern over the substantial increase in subsidies proposed for both clean tech and energy-intensive industries, even though these subsidies are linked to decarbonization goals. He also questioned the proposal to recast trade policy as an instrument of EU industrial policy – for example, by imposing local content requirements. Zachman (2024) criticized the lack of a clear rationale for supporting energy-intensive industries specifically. Martens (2024) argued that the report's emphasis on hardware and telecommunications is somewhat disconnected from current digital trends. Finally, Gros (2024) raised concerns regarding the unclear justification behind the EUR 800 billion investment gap and the ambiguity around what the proposed common debt should fund and how it would foster innovation.

In summary, while the Draghi report presents bold, thought-provoking recommendations and includes many valuable proposals, certain areas may benefit from additional clarification.

4.3 Mission letters to European Commissioner designates

By drawing on insights from the Letta and Draghi reports, as well as other policy recommendations, European Commission President Ursula von der Leyen outlined a series of targeted actions to enhance investment (Table 2).

Table 2: Summary of mission letters to European Commissioner designates which have a relevance for investment

Topic	Commissioner/VP	Relevant information for investments
Cohesion and Reforms	Raffaele Fitto (Executive Vice-President)	- Long-lasting reforms and investments. - Successful and full implementation of NextGenerationEU. - Strengthen competitiveness, resilience and sustainability. - Modernise cohesion and growth policy. - European Affordable Housing Plan: inject liquidity into the housing market.
Economy and Productivity; Implementation and Simplification	Valdis Dombrovskis (Commissioner)	- Stability and Growth Pact - Together with VP for Cohesion and Reforms, lead on NextGenerationEU. - European Semester. - Develop a new Competitiveness Coordination Tool - Enhance European Investment Fund for high-potential and fast growing European companies. - Strengthen the international role of the euro. - Progress on the digital euro. - Simplify, consolidate and codify legislation where needed. - Reduce administrative and reporting burden.
Financial Services and the Savings and Investments Union	Maria Luis Albuquerque (Commissioner)	- Develop a European Savings and Investments Union, including banking and capital markets. - Private and occupational pensions. - Review regulatory framework to ensure financial stability but also financing for innovative and fast-growing companies. Set risk-absorbing measures. - Scale up sustainable finance. - Explore measures to increase availability of venture and other risk capital. - Improve supervisory system at EU level - Further develop Banking Union and European Deposit Insurance Scheme - Unlock bank financing including securitisation - Improve digital finance and payments. - Strategy on financial literacy
Budget, Anti-Fraud and	Piotr Serafin (Commissioner)	- Support the President in preparing and negotiating the EU's next multiannual

Public Administration		budget. Simpler, more focused and responsive budget. - Link reforms with investments. - European Competitiveness Fund - A budget that de-risks and leverages. - Lead the work for new own resources. - Protect EU budget against fraud. Coordinating the implementation of Conditionality Regulation. - Responsible for modernisation of the Commission structure (HR, methods, operations…).

Source: Bruegel based on the mission letters.

5. Conclusion

This paper has examined the EU's investment landscape, highlighting the contradiction between the EU's persistent current account surplus—which implies that a large portion of European savings is invested abroad—and the substantial investment gaps in areas critical to the EU's future, including the green and digital transitions and defence enhancement. Various analyses indicate that EU investment needs to increase by about 4-5 percent of GDP to meet these priorities. Notably, if the EU's approximate 3 percent of GDP current account surplus were invested domestically rather than internationally, a significant portion of this investment gap could be addressed.

The EU's current account surplus is mainly driven by specific member states, including Germany, the Netherlands, Denmark, and Sweden. These countries exhibit considerable variation in investment rates: while Sweden's investment ratio is projected to approach 28 percent of GDP by 2029, the investment ratios of Germany, the Netherlands, and Denmark are expected to remain below 22 percent. The high investment rate in Sweden invites further investigation into the specific factors driving its growth, while barriers to investment in the other three countries include regulatory restrictions, limited access to venture capital, labour shortages, weak entrepreneurship skills, and administrative burdens.

By analysing foreign direct investment (FDI) and portfolio investment (PI) patterns in the main current account surplus countries, this paper sheds light on the composition, geographic distribution, and trends in EU foreign assets and liabilities using bilateral datasets. The data highlights the EU's evolving investment landscape, reflecting both historical ties within Europe and increasing diversification towards global markets. Germany exhibits a strong preference for EU-based investments, while financial hubs like the Netherlands exhibit broader diversification, aligning with their status as major international financial centres. This distinction reflects a dual role in the EU's advanced economies: as core intra-EU investors and as conduits for global capital flows.

The Netherlands and Ireland stand out as key financial centres in the EU, channelling large volumes of global capital through their borders due to their favourable financial intermediation and taxation, positioning these countries as attractive nodes for global capital routing. This intermediary role is evident in the large gross asset and liability stocks relative to GDP, allowing these financial centres to play a critical role in facilitating cross-border investments, even if such flows occasionally raise concerns over tax efficiency and regulation, as noted by researchers like Garcia-Bernardo et al. (2017).

For the Nordic countries, substantial investments in the USA —compared to relatively low investments in the EU—might signal the various investment barriers within the EU's single market. The relatively low share of investments in emerging markets, across Germany, Denmark, the Netherlands, and Sweden suggests that regulatory concerns and risk aversion still limit diversification toward these regions.

These findings reveal that EU investment patterns remain closely linked to intra-European relationships and established markets like the USA. However, a gradual shift in investment focus away from the EU toward the USA suggests a potential reorientation that could impact future EU capital flows. Policymakers may need to consider these shifts when developing regulatory frameworks to ensure both internal market cohesion and global competitiveness.

The recent Letta and Draghi reports offer complementary approaches to enhance EU competitiveness and foster investments to support the green transition, digitalization, and defence. The Letta report emphasizes completing the EU single market and reforming capital markets to mobilize private savings toward productive investments. Additionally, it calls for cross-border regulatory coherence, public-private partnerships, and EU-wide investment products, such as an EU long-term savings instrument, to stimulate transnational capital flows.

The Draghi report complements Letta's recommendations by stressing the need to modernize EU competition and innovation policies and to unify state aid and fiscal policy frameworks. With proposals for EU-issued common debt to finance industrial competitiveness, decarbonization, and energy resilience, Draghi envisions an EU with greater fiscal autonomy at the supranational level, enhancing the ability to make impactful investments. Additionally, both Letta and Draghi underscore the importance of enhanced governance to reconcile discrepancies in technical and administrative capacities across member states, with some concrete proposals for improvement.

Both reports, however, have encountered critiques. Concerns were about the Draghi report's proposed subsidies for clean tech and energy-intensive industries and its use of trade policy as an industrial strategy. More clarity is needed regarding the objectives of common debt issuance and its potential for fostering innovation. The October 2024 IMF World Economic

Outlook forecasts a decline in EU investment rates for 2024-2029, suggesting a mistrust of whether shifting more EU foreign investment back into the EU to address the investment gap could be successful.

In sum, as the EU continues to strengthen its internal investment networks, its global investment presence will depend on balancing intra-EU integration with diversification toward high-growth international markets. The incoming EU leadership will face the substantial challenge of addressing investment gaps, including incentivizing the utilisation of European savings within the EU. By implementing the forward-looking recommendations in the Letta and Draghi reports, the EU must foster an investment environment aligned with its strategic goals in environmental sustainability, digitalization, and defence.

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