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

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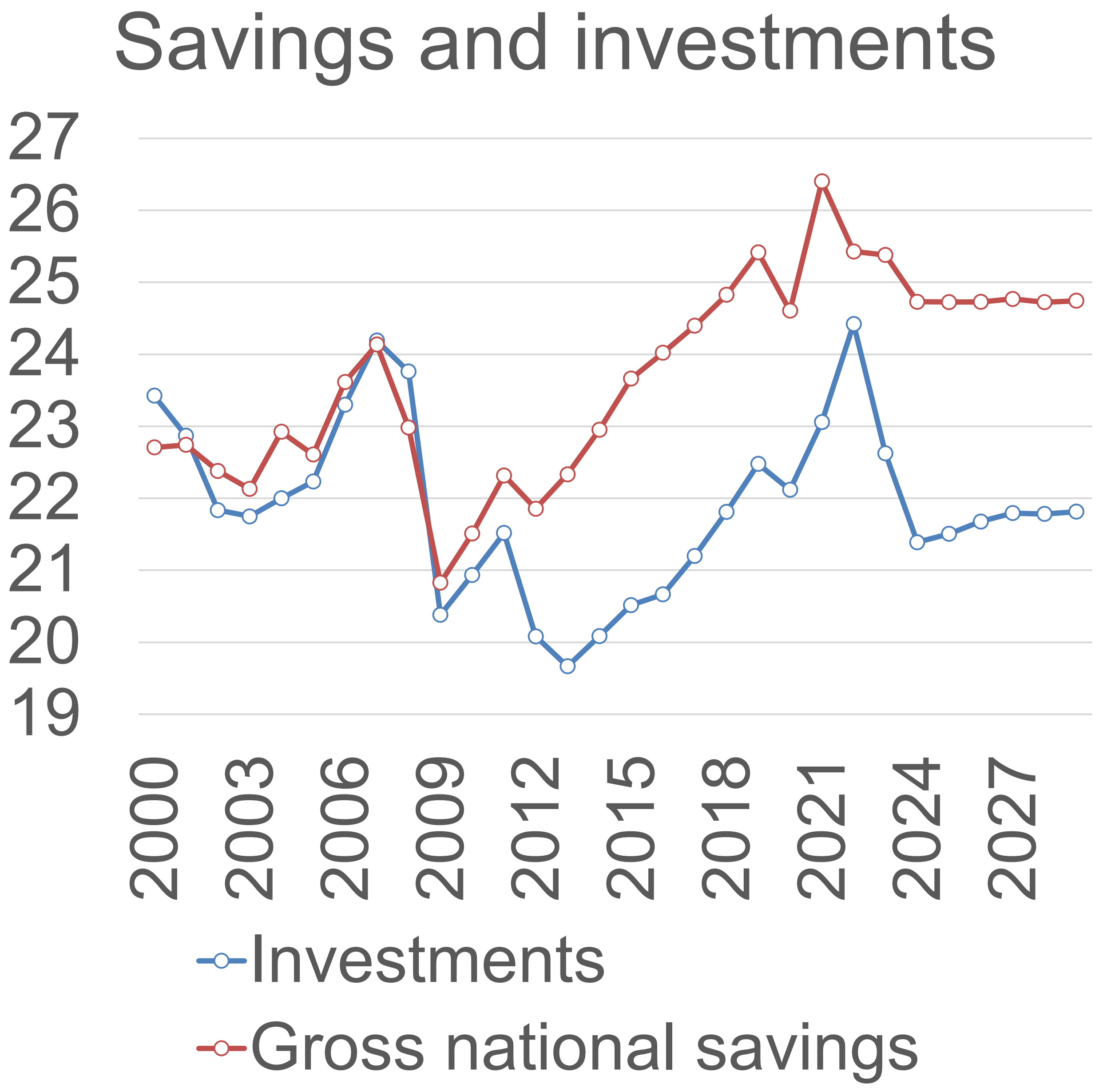
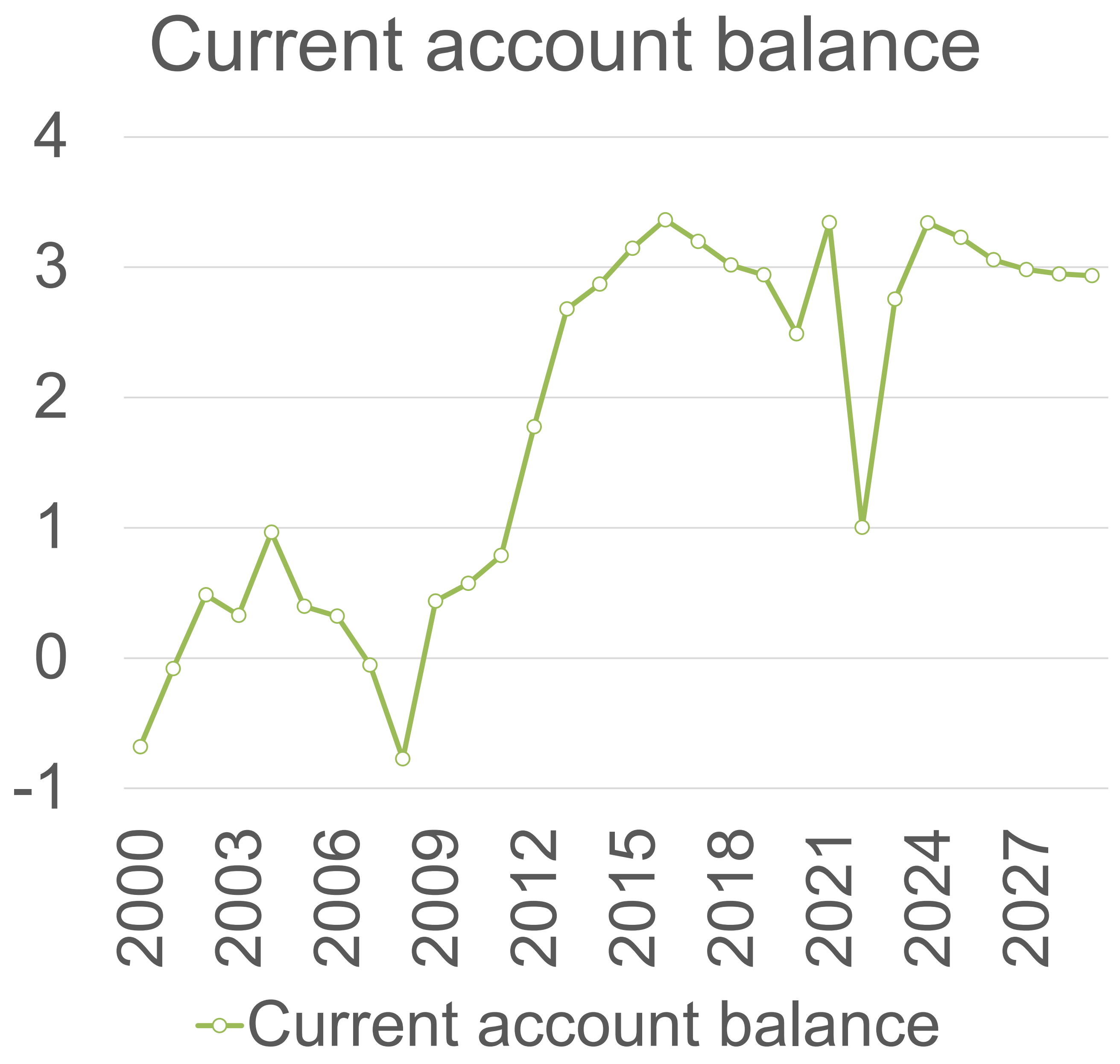
Nomura Foundation's Macro Economy Research Conference 2024 on 'Transformation of the Balance of Payments and Capital Flows', Tokyo, 31 October 2024

Puzzle: the EU has a large investment gap but a large share of European savings is invested abroad

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





- The current account balance has 3 interpretations:

1. the balance between domestic savings and investment
2. the balance with the rest of the world in terms of exports and imports of goods and services, factor incomes, and current transfers
3. the balance of capital flows with the rest of the world

Source: International Monetary Fund, World Economic Outlook Database, October 2024.
Note: 2024-2029 values are IMF forecasts.

Outline

1. The drivers of the European Union’s current account
2. The dynamics and composition of gross capital outflows and inflows in EU countries
3. Options to foster investments in the EU
4. Conclusions

1.1 Current account drivers

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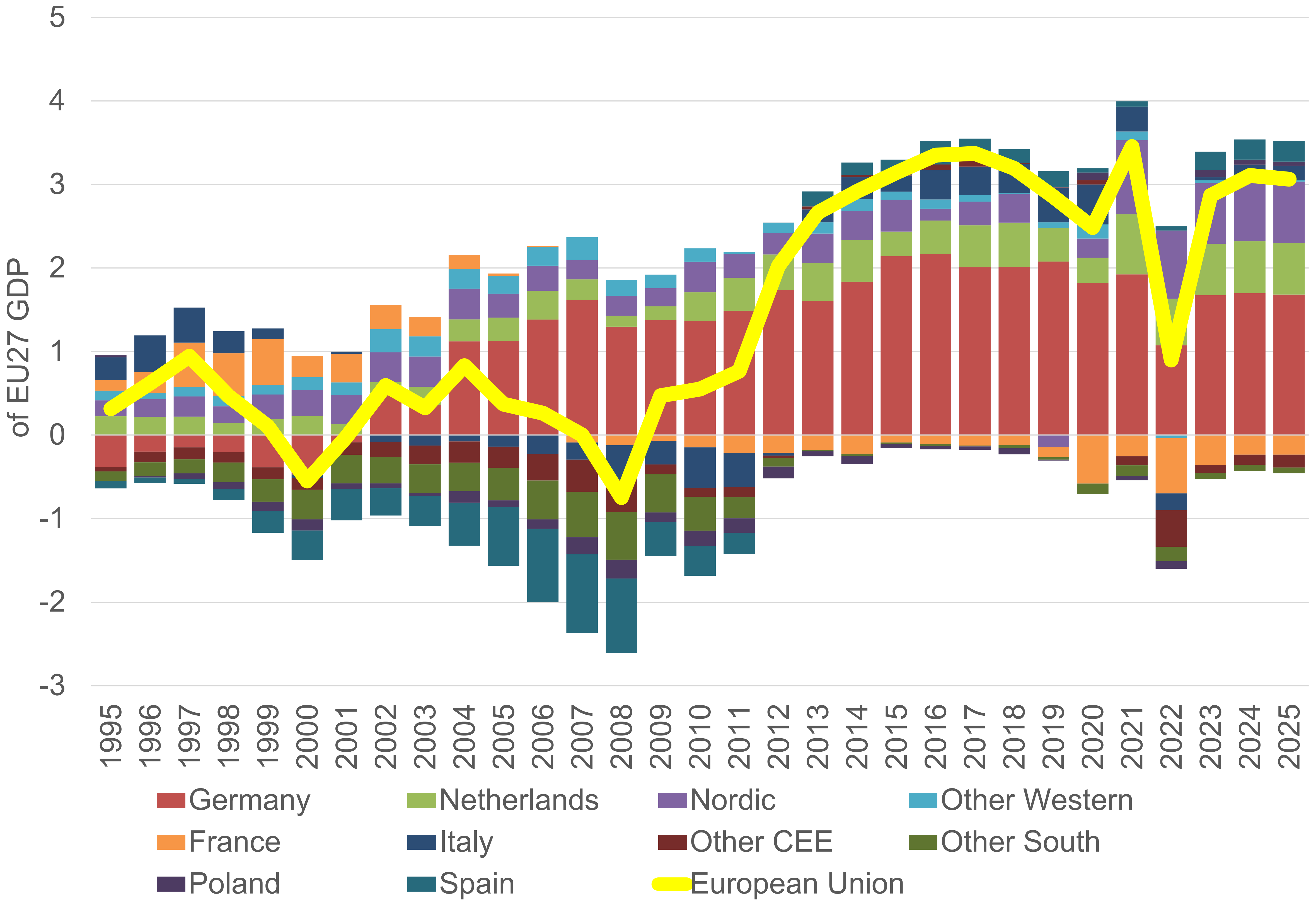
The country-composition of the European Union's current account balance (percent of EU GDP)



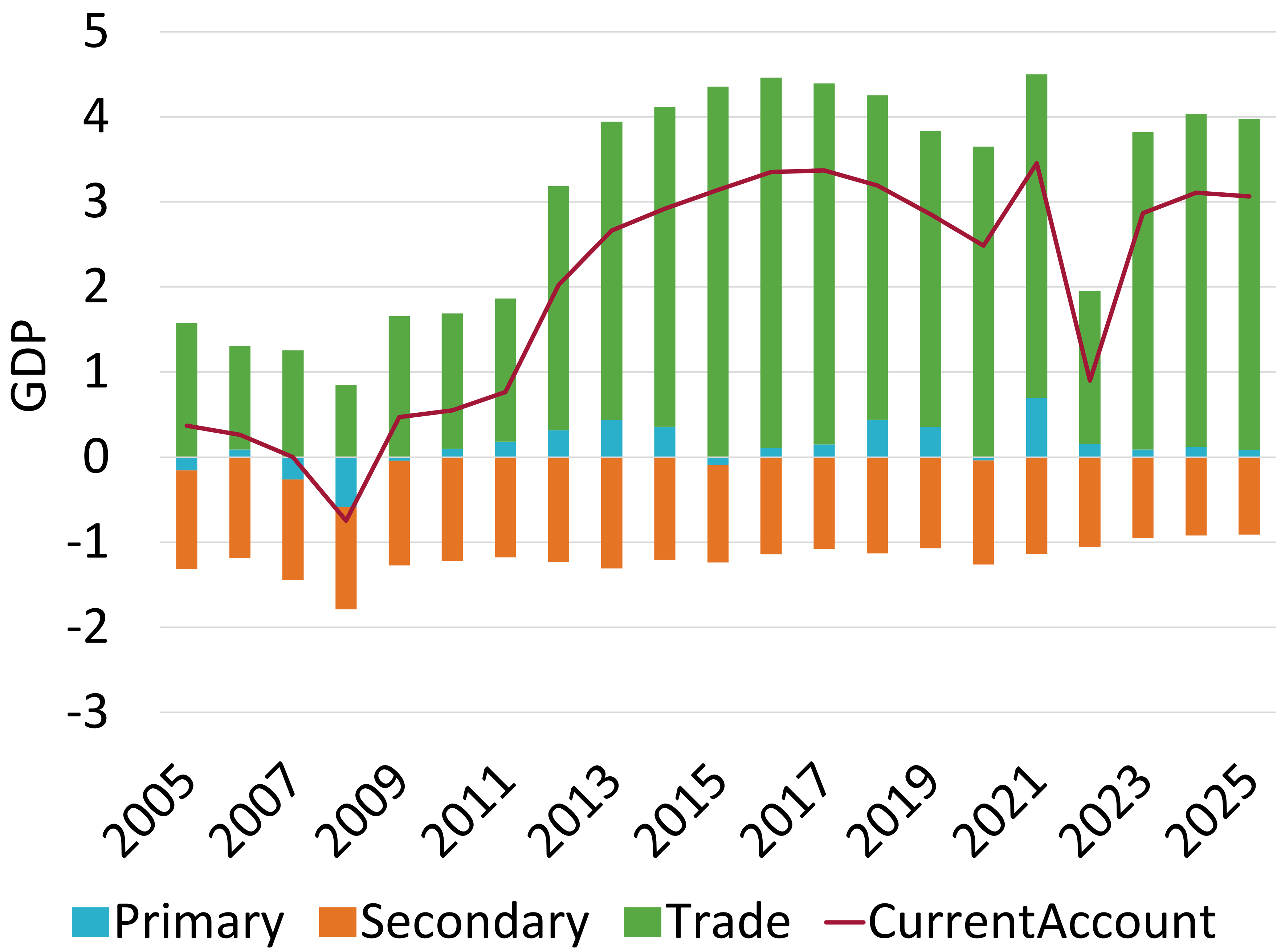
- Close to balanced EU current account in 1995-2008
- Pre-2009: surplus and deficit countries
- Post-2009: deficit countries moved to balanced position, surplus countries increased their surplus

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.

1.2 Current account drivers

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

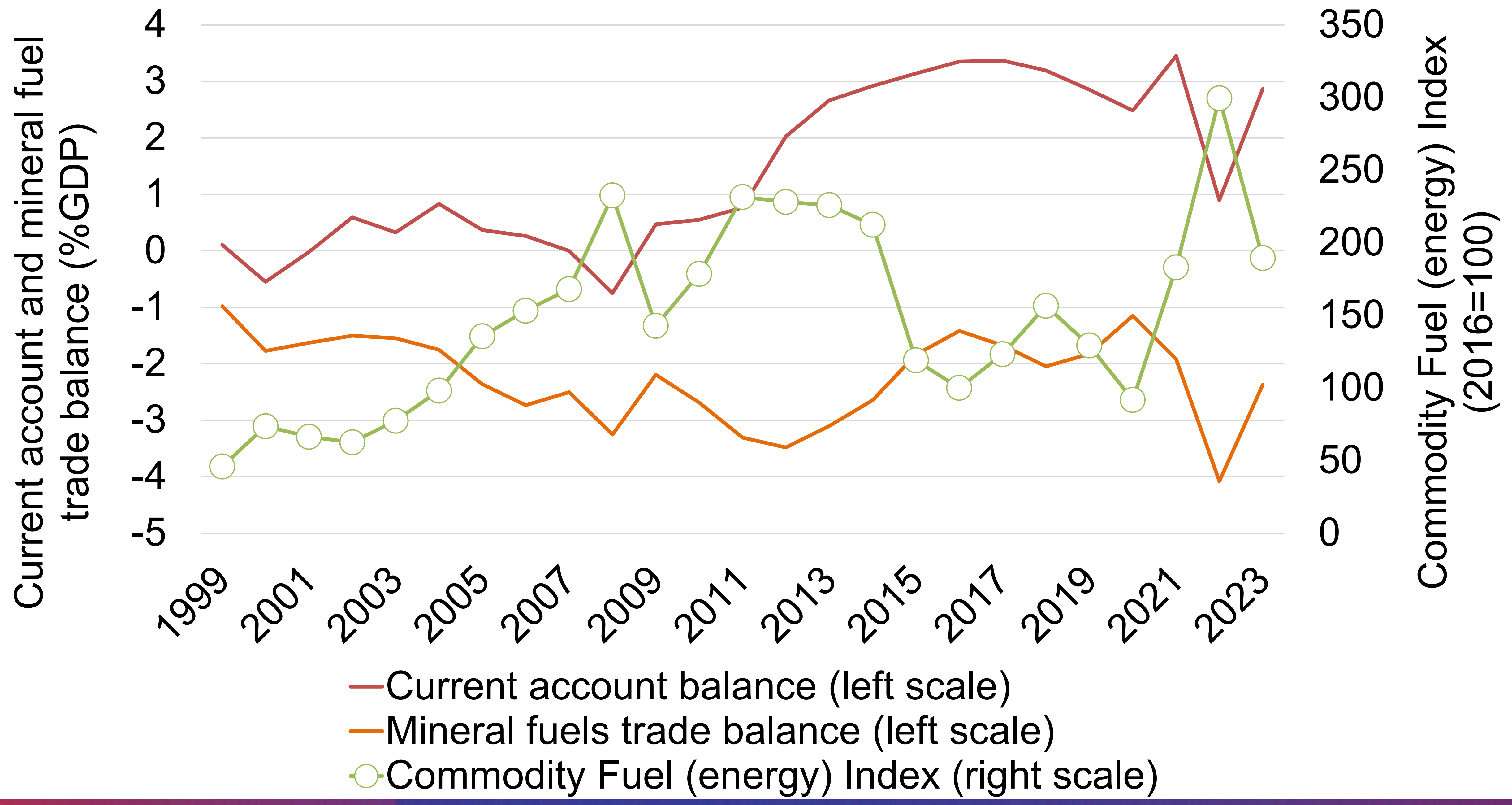


- EU current account changes are primarily driven by the trade balance
- Secondary income balance: consistently negative balance of close 1 GDP
- Primary income balance: close to zero
- *Note:*
- *Primary income (factor incomes), such as employee compensation and investment income*
- *Secondary income (various transfers), such as taxes on income and wealth, social contributions, personal transfers between resident and non-resident households, including workers' remittances.*

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

1.3 In 2022, high energy costs reduced the EU's current account surplus

The European Union's current account balance, mineral fuel trade balance, and global fuel prices

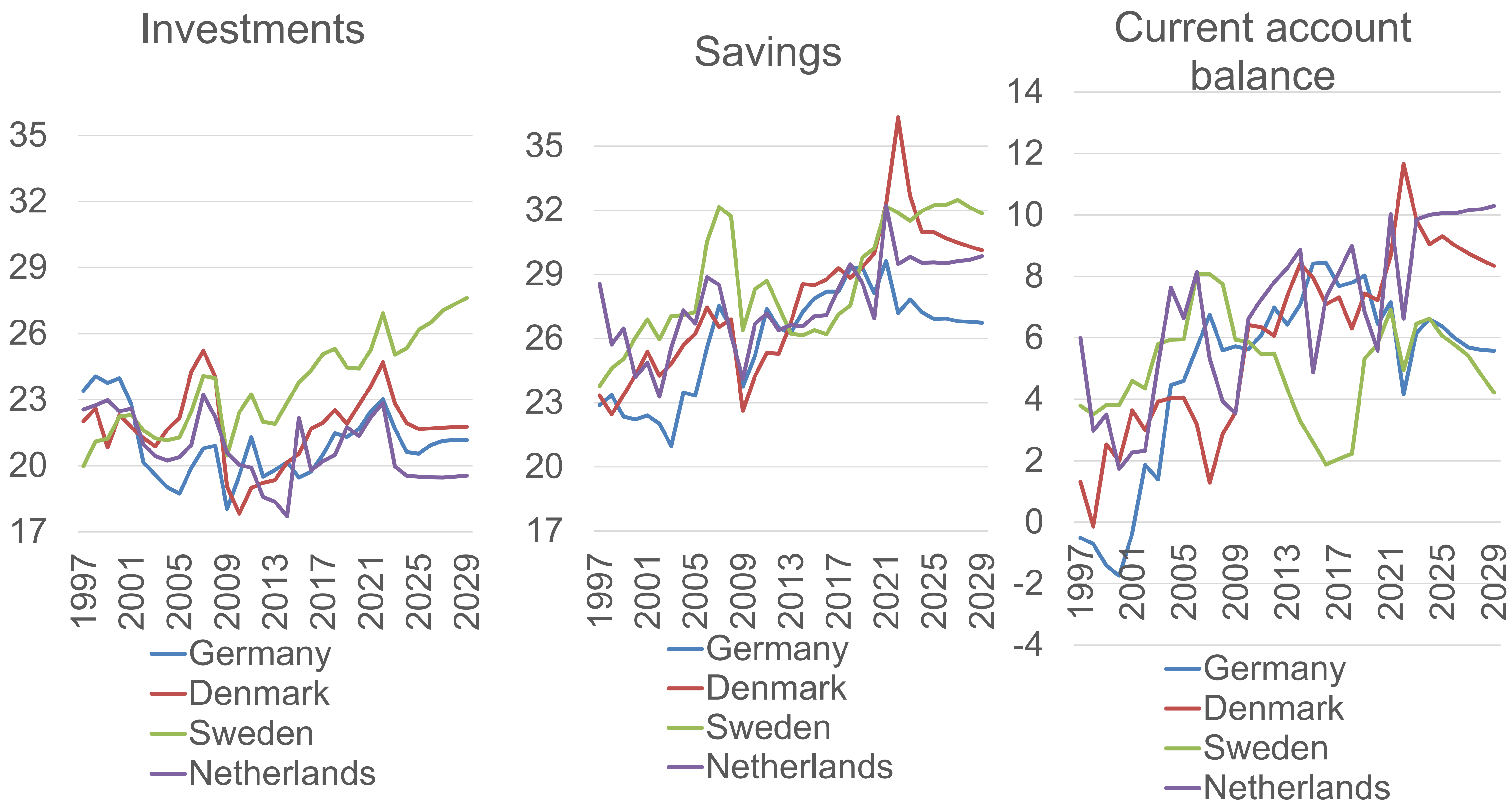


- Global commodity fuel prices strongly correlate with the EU's mineral fuel trade balance
- The drop from 2021 to 2022, and the increase from 2022 to 2023, are almost the same for the current account and the mineral fuel trade balances

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.

1.4 Persistent surpluses in four countries

Investments, savings, and the current account balances in Germany, the Netherlands, Denmark and Sweden (percent of GDP)



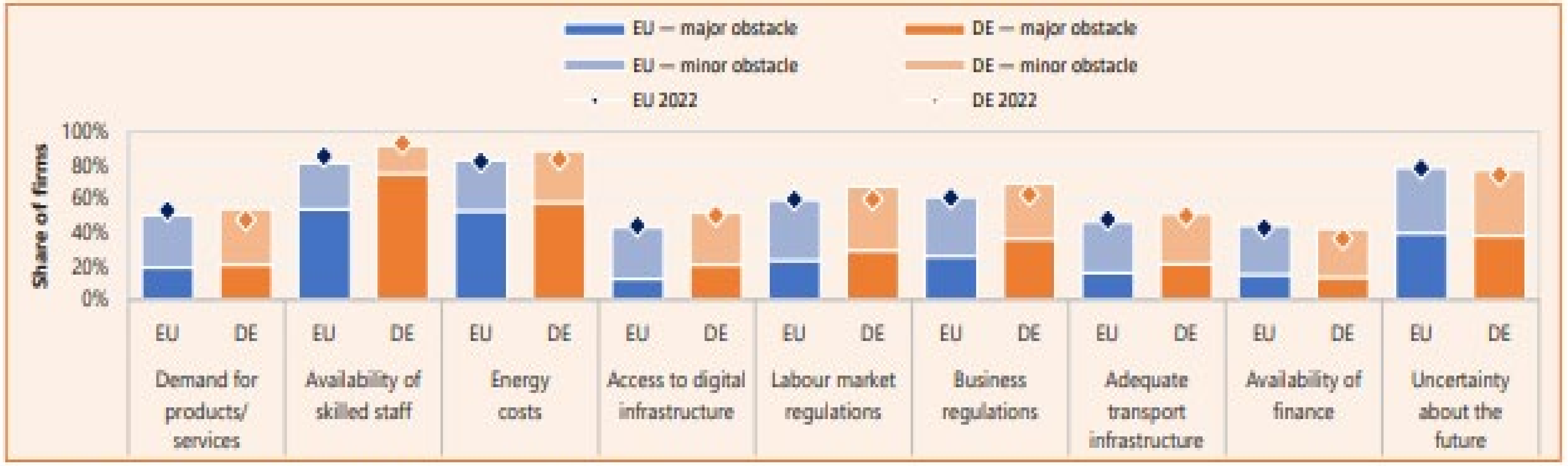
- Investment is much higher in Sweden than in the other 3
- Savings increased in all 4 during the past 3 decades
- Growing current account surpluses

Source: International Monetary Fund, World Economic Outlook Database, October 2024. Note: 2024-2029 values are IMF forecasts.

1.5 Reasons behind Germany’s current account surplus

- High savings: households – population ageing, tax, labour market, and pension reforms; and perhaps ‘culture’
- ‘Corporate savings glut’: partly stems from low investment levels because:
    - Lack of incentives
    - High administrative burden
    - Regulatory barriers to market entry and competition
    - Weak entrepreneurship skills
    - Shortages of skilled labour
    - Uncertainties
    - Limited venture capital financing

Survey responses on the barriers to investment in Germany



Q. Thinking about your investment activities, to what extent is each of the following an obstacle? Is it a major obstacle, a minor obstacle or not an obstacle at all?

1.6 Reasons behind the current account surpluses of the Netherlands, Denmark and Sweden

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- Netherlands: the presence of multinational companies; specific features of the Dutch tax and pension systems that promote higher household savings; high savings of small and medium-sized enterprises; investment obstacles, labour shortages, limited capacity in the electricity grid
- Denmark: highest savings among the 4 countries in the 2010s; large foreign assets generate primary income surplus; inconclusive literature on stagnant domestic investment
- Sweden: rather high investments, and even higher savings; primary income from foreign assets

2.1 Capital flows and international investment positions

International investment position of the EU27 relative to non-EU27 countries, 2014-2023 (percent of 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

- The negative net investment position in 2014 moved to close to balance by 2023
- Main driver: portfolio investment assets

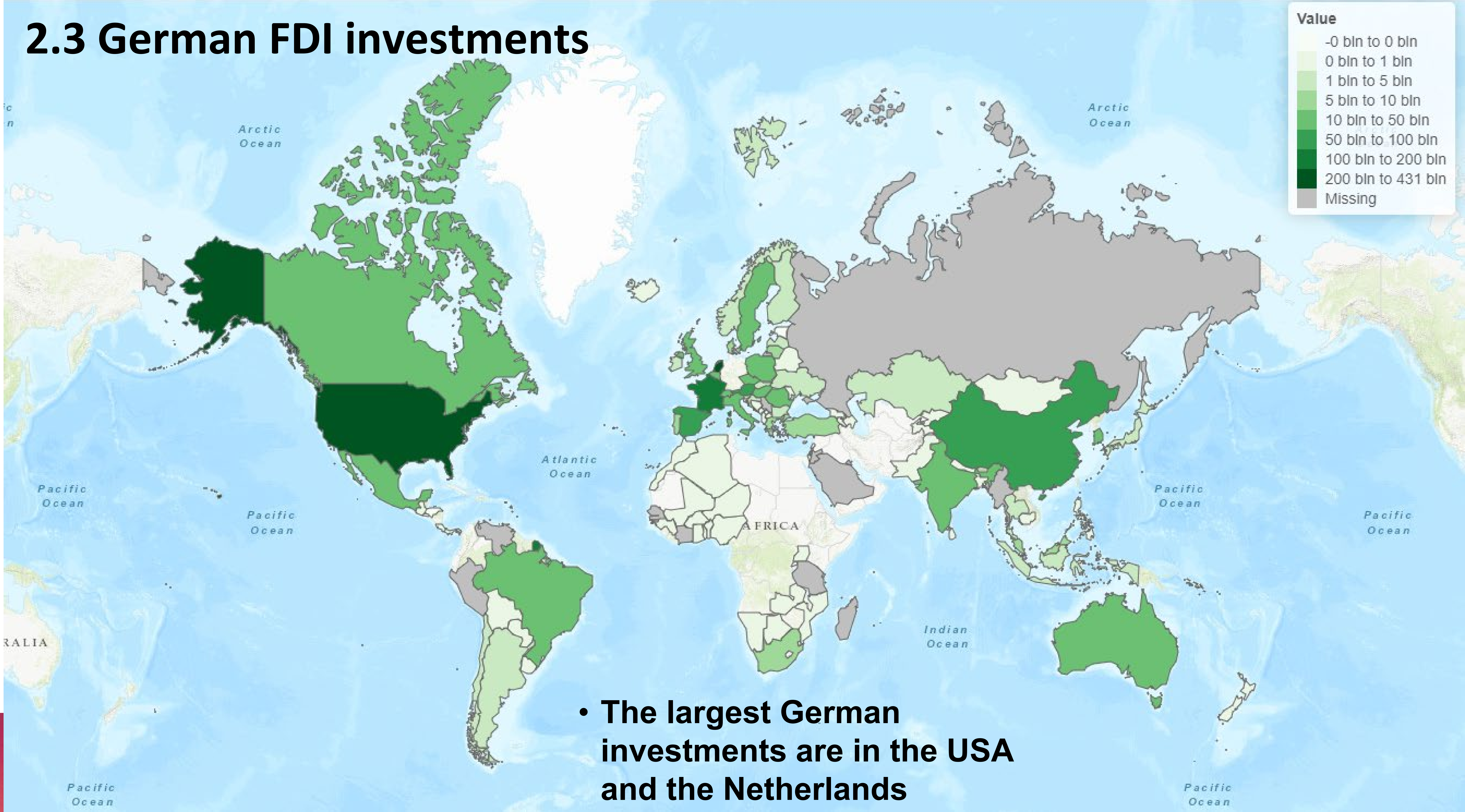
Source: Bruegel based on Eurostat's 'International investment position - quarterly and annual data (BPM6) [bop_iip6_q]' and 'GDP and main components (output, expenditure and income) [nama_10_gdp]' datasets.

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

2.2 Bilateral capital flows

- We use three bilateral datasets:
  - (1) IMF Coordinated Direct Investment Survey (CDIS);
  - (2) IMF Coordinated Portfolio Investment Survey (CPIS);
  - (3) BIS Locational Banking Statistics (LBS)
- These datasets include stocks – not possible to derive flows, because the change in stock is the sum of flows and revaluation
- Darvas and Hüttl (2017): valuation changes have been more substantial than current account and financial transactions for several countries

2.3 German FDI investments



- **The largest German investments are in the USA and the Netherlands**

2.4 Germany: geographical composition of FDI and PI investments abroad

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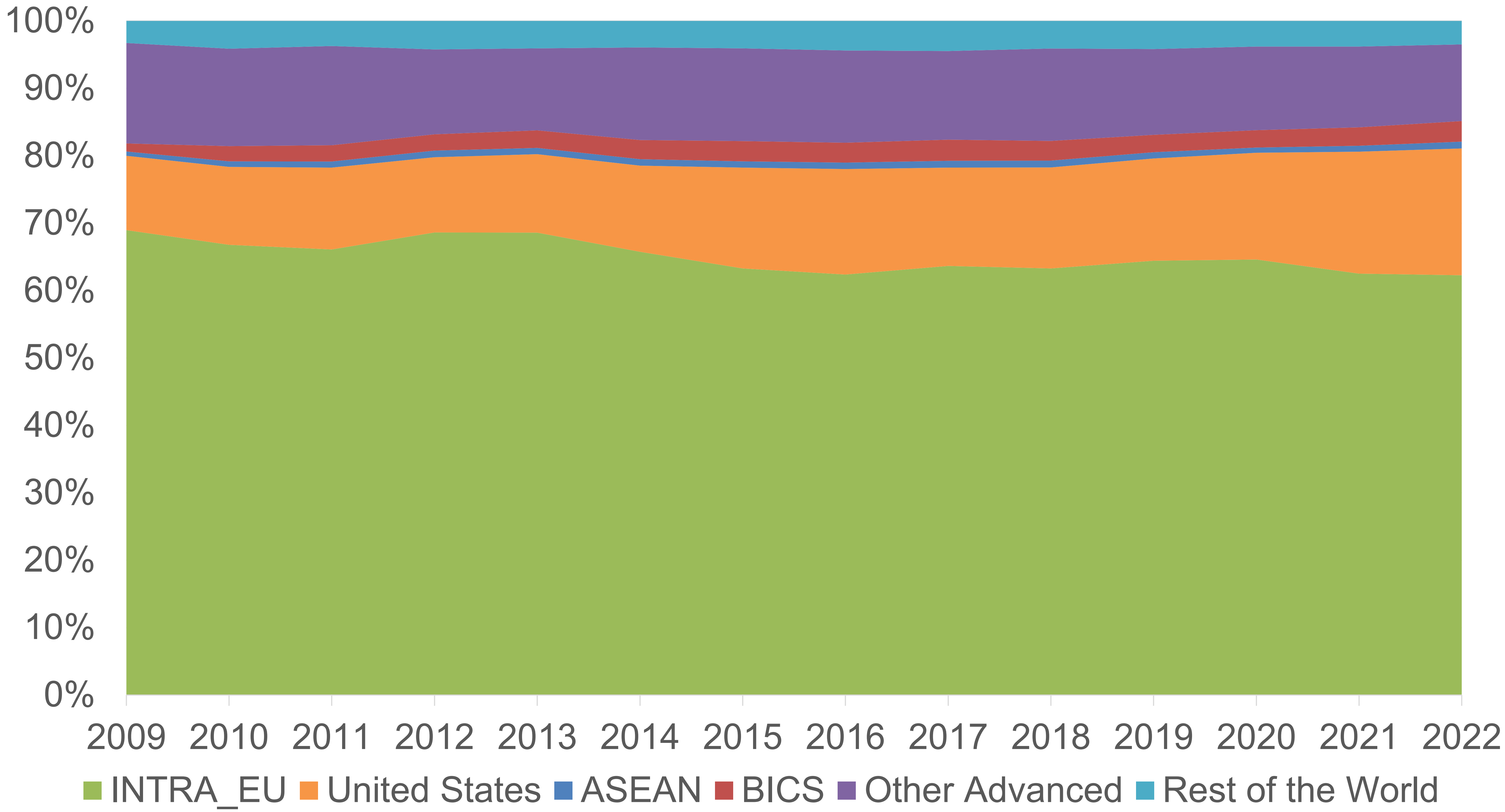
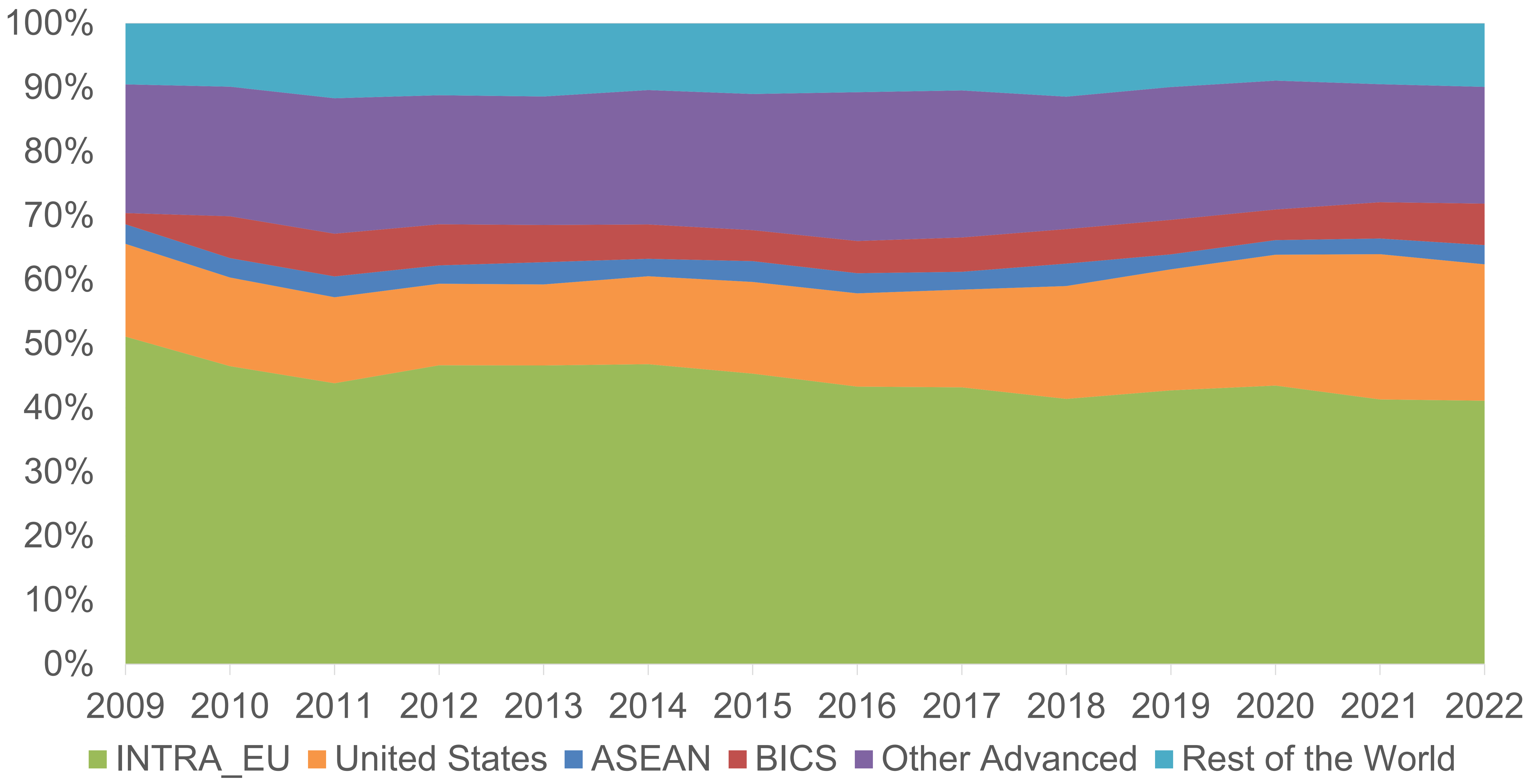


- The share of intra-EU investments fell from 69% in 2009 to 62% in 2022
- Share of US increased from 11% to 19%
- Share of BICS (Brazil, India, China, South Africa) increased from 1% to 3%

Source: OECD

2.5 Netherlands: geographical composition of FDI and PI investments abroad



- The share of intra-EU investments fell from 51% in 2009 to 41% in 2022
- Share of US increased from 14% to 21%
- Share of BICS (Brazil, India, China, South Africa) increased from 2% to 6%

Source: OECD

2.6 Bilateral capital flows

- The share of EU is going down, while the share of US and some emerging markets is going up: this might reflect international diversification towards economically more dynamic areas

- 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 could reflect that the Netherlands is a "*conduit offshore financial centre*" (Garcia-Bernardo et al., 2017), which re-route international investments and facilitate capital transfers without taxation
- Ireland was also found to be a "*conduit offshore financial centre*"

3.1 Options to foster investments in the EU

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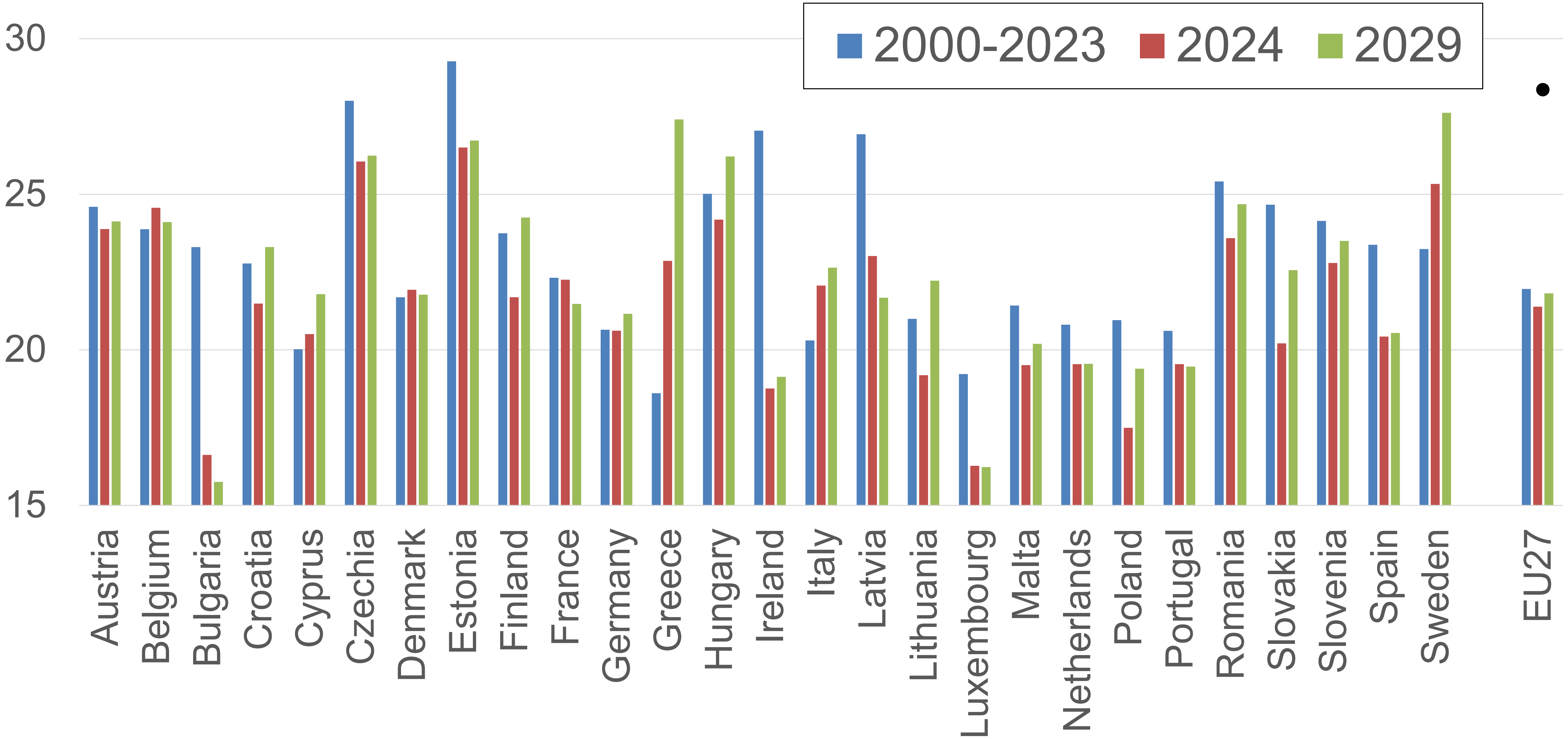
Investment rates in EU countries (% GDP)



- Investment rates vary widely across the EU

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.

3.2 EU investment gaps

- European Commission (2023), EU green investments:
  - 2011-2020: €764 billion per year (equivalent to 4.8% of EU GDP in 2022)
  - To reach the 55% reduction target by 2030, total annual investment needs to increase to €1,241 billion (7.8% of EU GDP in 2022)
  - So, the gap is €477 billion per year 3% of EU GDP in 2022)
- Additional investment gaps in digital, defence (and social) investments
- Draghi report: annual €750-800 billion shortfalls in investment, 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

3.3 Overlaps between Draghi report, Letta report, and Bruegel 2024 memos to EU leadership

1. Single market reforms: services, labour mobility, capital markets, banking union
2. Reduction/reform of regulation
3. Higher public investment for green and digital transitions; cross-border infrastructure, grids
4. Greater exploitation of EU-level efficiency gains: coordination of investment and policies; EU budget focused on European public goods
5. A greater role for EU-level industrial and innovation policy
6. Reform of EU decision-making for speed, efficiency; reduce veto power of individual members

The difficulty: this agenda is not entirely new (main exception: point 5)

The (well-known) reason: EU governments accountable to their populations, not the EU population as a whole. Limits delegation, coordination, harmonization, and fiscal sharing.

3.4 Bruegel researchers’ advice to the new EU leadership: main policy priorities

1. **Deepen single market and coordinate policy in areas of highest growth impact**
   - Energy policy and investment, capital markets, banking union, services markets
2. **Curb regulatory excess and make regulation more growth friendly**
   - Systematic impact assessment, independent ex-post evaluation, single digital regulator
3. **Improve and expand EU-level innovation and industrial policy**
   - Mission oriented (e.g. green competitiveness) and competition friendly, executed by an independent institution
4. **Reform and (only then) expand EU budget**
   - Focus on climate, cross-border infrastructure, international partnerships, innovation. National co-financing of CAP
5. **Defend competition, openness, and multilateralism**
   - Countervailing tariffs can be necessary, but within multilateral rules. Defend and reform WTO with like-minded members
6. **Safeguard the Green Deal and extend its global reach**
   - Protect vulnerable groups; scale up cost-effective international climate finance (together with G7 partners)
7. **Support Ukraine, strengthen EU defence, and create a single market for the defence industry**
   - This could justify common EU borrowing and a new off-budget fund (including to accelerate rearmament)
8. **Address economic security blind spots**
   - Dependence via export and profit concentration, foreign assets, payment systems rather than just imports
9. **Reset relationship with the UK**
   - Ensure regulatory alignment; include UK in in single market for defence production
10. **Reform EU decision-making for greater efficiency, and to prepare for enlargement**
    - Majority voting procedures; staged accession

Based on chapters published in: Maria Demertzis, André Sapir and Jeromin Zettelmeyer (eds): Unite, defend, grow: Memos to the European Union leadership 2024-2029, Bruegel, https://www.bruegel.org/anthology/memos-european-union-leadership-2024-2029

3.5 Bruegel recommendations vs the Draghi report

The similarities

1. Similar approach: understand trade-offs, push political red lines where needed. Analytical. Smart *and* brave.
2. Similar emphasis on doing more at EU level when this is efficient.
3. Similar recommendations in many policy areas: innovation policy, (de)regulation, single market, competition policy, investment (public and private), the EU budget, safeguarding the Green Deal, strengthening EU defence, and improving EU governance for speed and efficiency,

The differences – what Draghi proposes (or not)

1. No pitch for maintaining rules-based international trade. Trade policy in the service of industrial policy
2. A strong pitch for large-scale EU-level subsidies to industry, particularly energy-intensive industry
3. Greater emphasis on near-term reduction of energy prices (including by reducing the fiscal burden on energy)
4. A narrower understanding of EU economic security, focused on reducing import dependence
5. No discussion of the international dimension of climate action and how it might be affected by EU policies

4. Conclusions

- Contradiction between the EU’s persistent current account surplus (about 3% of GDP)—which implies that a large portion of European savings is invested abroad—and the substantial investment gaps (about 4-5% of GDP)
- If the EU's 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 Germany, the Netherlands, Denmark, and Sweden. The Swedish investment rate is the highest in the EU; the other 3 invest less.
- There is a need to raise investment throughout the EU, and there would be a scope and rationale for current account deficits in the south and east of EU
- Capital flows: a gradual shift in investment focus away from the EU toward the USA and emerging markets suggests a potential reorientation towards more dynamic areas
- The recent Letta and Draghi reports: old and new lessons
- The incoming EU leadership: substantial challenge of addressing investment gaps, while IMF projections expect this will be unsuccessful

Thank you!

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