Flash Economics

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The vicious circle of under-investment in Europe and the attractiveness of the United States

The United States is increasingly attractive to European companies.

In 2024, European Union (EU) companies carried out 29% of their industrial investments in the EU, for 26% in the United States.

This strong attractiveness of the United States for investment is linked to stronger growth in the United States (2.5% in 2023 compared with 0.8% in the EU), the larger size of the new technologies sector (10% of GDP in the United States, 5.5% of GDP in the EU), different policies (Inflation Reduction Act) in the United States, the higher return on capital (corporate ROE is 15% in the United States compared to 10% in the EU), the much larger size of the US equity market, and the small size of European venture capital (fundraising will reach €22 billion in 2023 in the EU, compared with $250 billion in the United States).

The result is a vicious circle for the European economy: the under-investment that stems from allocating a large share of investment to the United States weakens productivity gains and growth and makes Europe even less attractive for investment.

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Investment attracted to the United States

If we look at the **rate of business investment** (total or in new technologies) (**Charts 1a/b**), or **net direct business investment** (**Chart 2**), one can see that capital is being diverted from the eurozone to the United States. Chart 2 shows the balance of direct and portfolio investment in the United States and the eurozone. **Inward investment is significantly higher in the United States than in the eurozone** (a negative sign indicates a positive balance for capital inflows).

Chart 1A
Investment of non-financial corporations
(in value terms, as % of nominal GDP)

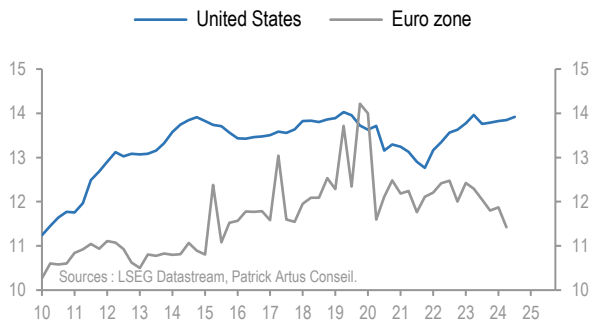


Chart 1B
ICT investment including software
(in value terms, as % of nominal GDP)

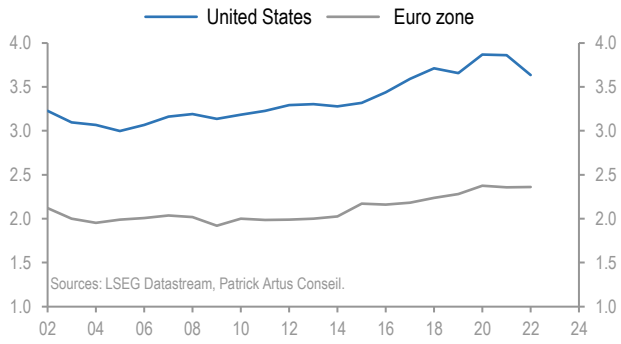
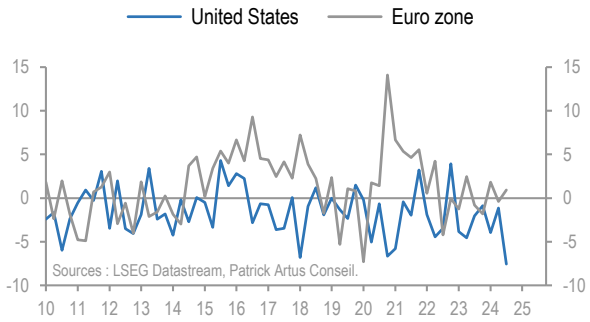


Chart 2
Net direct and portfolio investments*
(as % of nominal GDP)

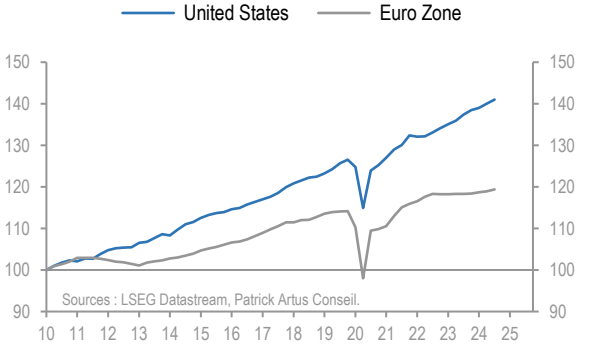


(*) The direct and portfolio investment balance represents the change in the net international investment position. An increase in the net international investment position has a positive sign

This **strong attractiveness of the United States for investment is the result of**:

- **The gap in growth** between the United States and the eurozone (or the European Union), **Chart 3**.

Chart 3
Real GDP (2002.T1 = 100)



- The larger size of the **new technology sector in the United States** (10% of GDP compared with 5.5% of GDP in the European Union);
- The effectiveness of **other investment policies in the United States** (e.g. the Inflation Reduction Act);
- **The higher profitability of companies** in the United States compared with the eurozone (Chart 4);
- **The small size of the venture capital industry** (fundraising will amount to 22 billion euros in the EU for 250 billion dollars in the United States in 2023);
- **The small size of the stock market in the eurozone relative to that in the United States** (**Chart 5**).

Chart 4
RoE

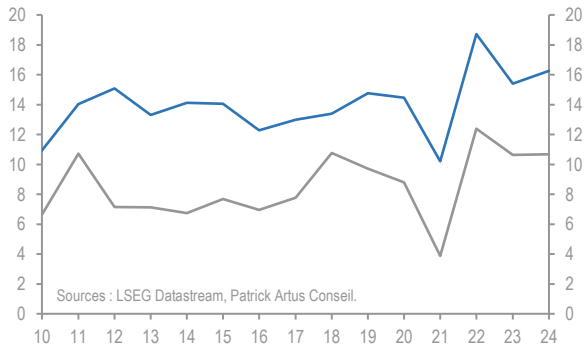
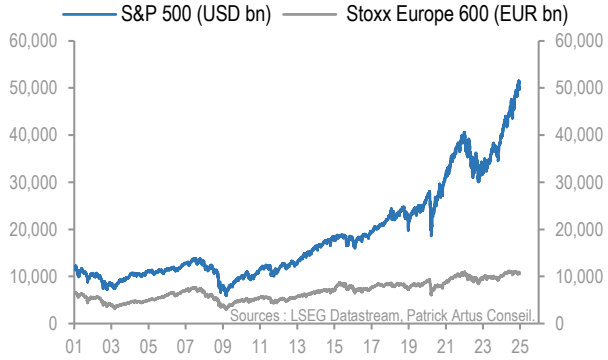


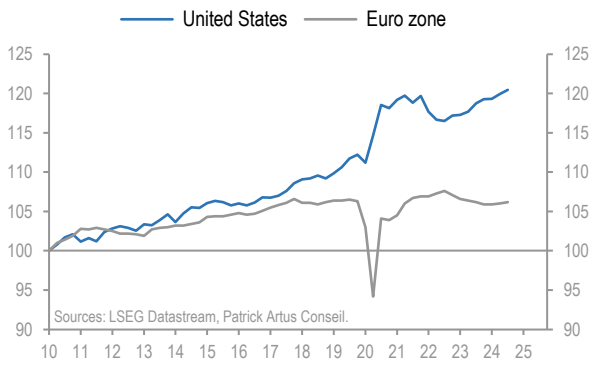
Chart 5
Market capitalisation



Summary: the strong attractiveness of the United States creates an unfavourable vicious circle in Europe

Since investment, and particularly investment in new technologies, is attracted to the United States, to the detriment of Europe, **the rate of investment** (total and in new technologies) **is abnormally low in Europe** (Charts 1A/B).
As a result, productivity gains are very low in Europe (**Chart 6**), as is GDP growth (Chart 3 above).

Chart 6
Productivity per capita (2010.Q1 = 100)



This is indeed a **vicious circle**: the more companies are encouraged to locate their investments in the United States rather than in the European Union, the lower the growth and return on capital in Europe compared with the United States, which makes the United States more attractive for investment than Europe.

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