Flash Economics

N° 103
August 21st, 2025

Keeping European savings in Europe will be very difficult

Europe has a large current account surplus, which means that an equally large proportion of Europeans' savings are invested in the rest of the world (or lent to the rest of the world); these are primarily investments (financial or corporate) from Europe to the United States.

We know that if Europeans kept all their savings in Europe, the problem of insufficient investment would be largely solved. But it would be very difficult to keep Europeans' savings in Europe; it would mean:

- That European public debt markets would have to be as liquid as the US Treasuries market;
- That the European equity market would have to be as large as the US equity market;
- That European financial markets would have a single regulator, a common bankruptcy law;
- That the profitability of European companies be as high as that of American companies, which would necessitate a distortion of income distribution to the detriment of European employees, very strong growth in the European venture capital market, and the development of a technology sector in Europe as large as that of the United States.

Europe's recent investment promises to the United States are certainly not a step in the right direction.

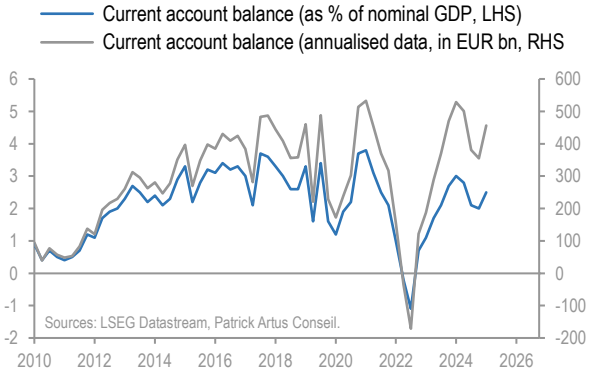
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Europe's savings surplus

The European Union has a **large current account surplus** (**Chart 1**), which means that a significant proportion of European savings are invested in or lent to the rest of the world. We know that the transfer of savings from Europe to the United States is very substantial, probably on the order of Euro 400 billion a year.

Chart 1
European Union: Current account balance



We are well aware of the **huge need for additional investment in Europe** to finance its energy transition, its digital transition, and investment in disruptive technologies. The **Draghi report** evaluates the need for increased investment in the European Union at Euro 800 billion per year (4.4% of GDP), to which should be added the necessary increase in military spending, from 1.9% of GDP in 2024 to at least 3% of GDP.

Keeping European savings in Europe

We can see that **if Europeans were to keep all their savings in Europe**, bringing the current account balance to 0, the European Union would have around Euro 500 billion more available each year for investment, representing over 60% of the increase in investment estimated by the Draghi report.

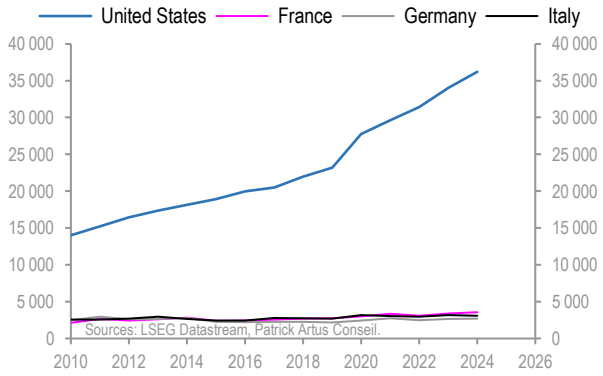
The objective of keeping European savings in Europe is therefore completely legitimate. But this objective will be very difficult to achieve.

Why it will be difficult to keep European savings in Europe

1. Insufficient liquidity in public debt markets

The US public debt market (the Treasuries market) has **significantly higher liquidity than European public debt markets**, because it is not segmented into multiple issuers like the European market (**Chart 2**).

Chart 2
Public debt (in USD bn)



This makes the US government debt market more attractive to investors.

2. Insufficient size of the European stock market

Chart 3 shows that **market capitalization in the USA is considerably higher than in Europe**, due to the greater number and size of companies listed in the USA, as well as the higher valuation of US equities (**Chart 4**).

Chart 3
Market capitalisation (in USD bn)

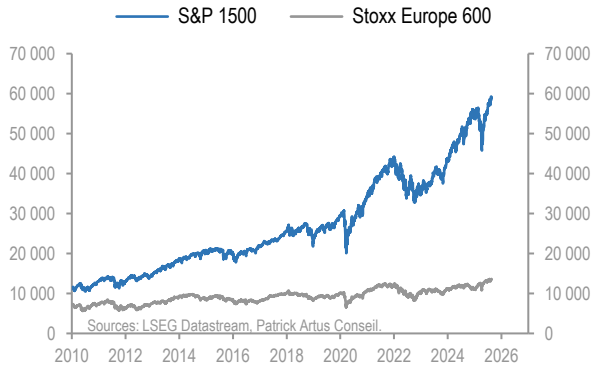
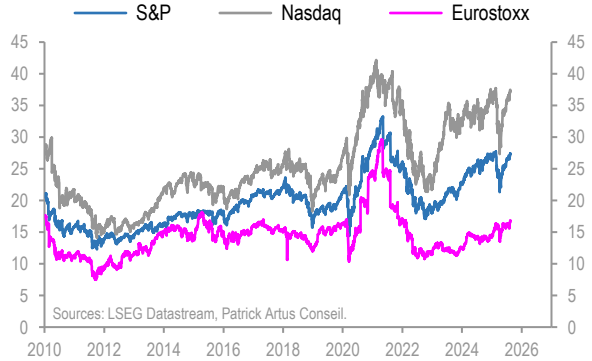


Chart 4
P/E ratio



The larger size of the US equity market attracts capital from Europe.

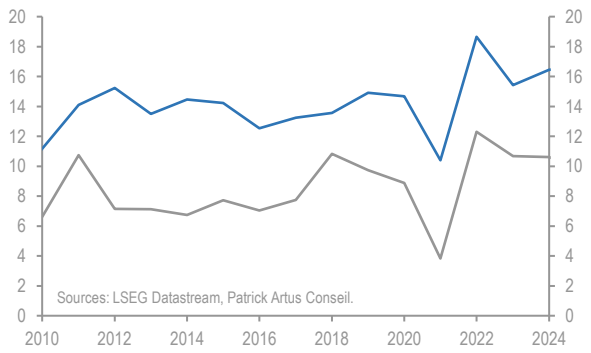
3. No capital markets union in Europe (savings and investment union)

We know that the European Union has not succeeded in unifying its capital markets, which means in particular that there is a **multiplicity of regulations and a multiplicity of bankruptcy laws**. It is therefore more difficult to invest in Europe than in the United States

4. Higher return on capital in the US than in Europe

ROE (return on equity) for US companies is significantly higher than for European companies (**Chart 5**).

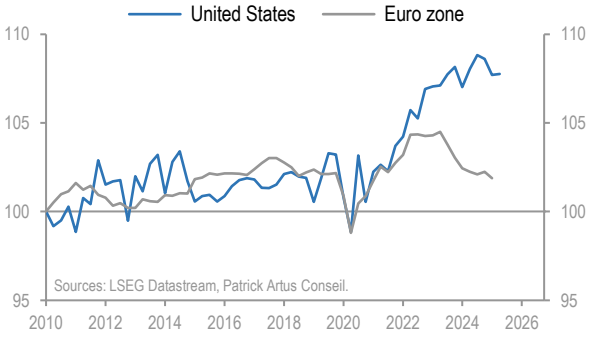
Chart 5
RoE



For European companies to have profitability comparable to that of American companies, they would have to:

- **distort income distribution in Europe in favor of profits** (**Chart 6**), which would generate income inequalities and a concentration of wealth that are not desirable;

Chart 6
Ratio between productivity per hour worked and real hourly compensation (2010.Q1 = 100)



- **significantly increase the size of the venture capital industry in Europe** (venture capital funds raised in 2024 reached Euro 22 billion in the European Union and USD 250 billion in the United States), in order to also increase the size of the new technologies industry (**Chart 7**) and that of investment in new technologies (**Chart 8**).

Chart 7
Gross value added of the ICT sector
(as % of nominal GDP)

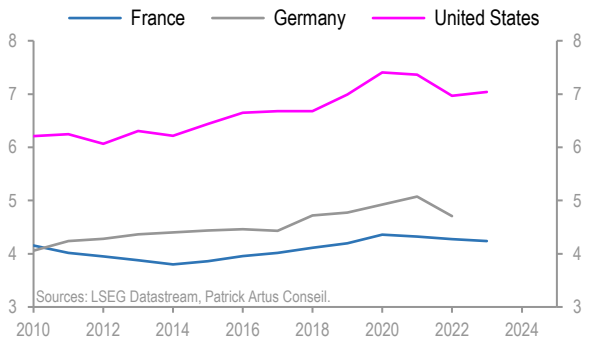
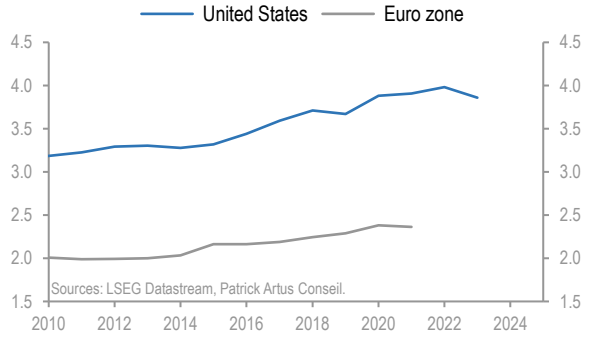


Chart 8
ICT investment including software
(in value terms, as % of nominal GDP)



Summary: a central objective, but very difficult to achieve

The objective of keeping Europeans' savings in Europe is central, because if this objective were met, the increase in investment that it would be possible to finance in Europe would reach 60% of the Draghi plan's objective of increasing investment, both public and private. But this target will be very difficult to achieve, due to:

- the segmentation of public debt markets in Europe;
- the low market capitalization of European companies;
- the absence of a capital markets union;
- the low profitability of European companies, compared with that of American companies, due on the one hand to the absence of any deformation of revenue sharing in favor of profits (such a deformation being undesirable), and on the other hand to the small size of the new technologies sector, which can be linked to that of the venture capital industry in Europe.

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