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German investment becomes focus of international politics

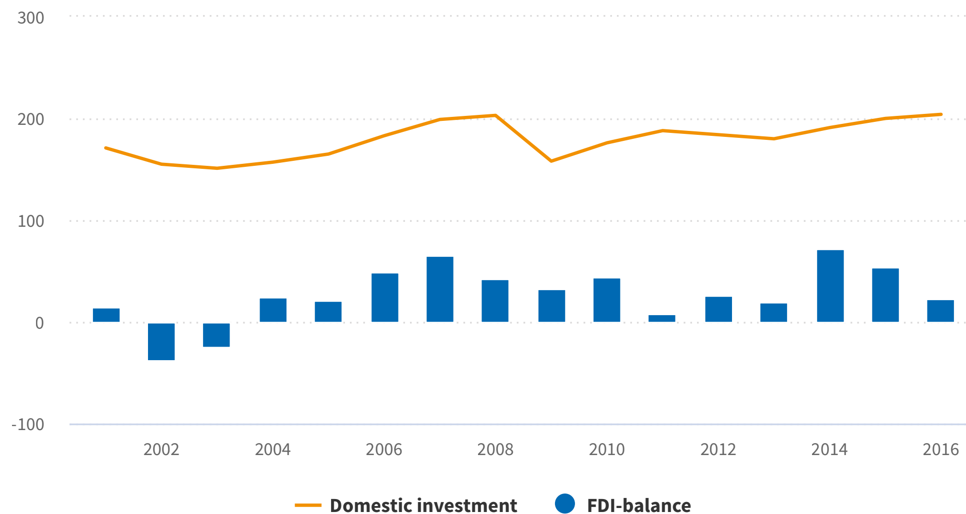
Weak domestic investment is regarded as a reason for the large German current account surpluses. This context ignores the internationalisation of production and investment as well as intertemporal savings and consumption decisions.

Overall investment activity in Germany is currently a hot topic in international economic policy discussions. In the controversy over Germany's large current account surpluses, the argument is regularly put forward that imports of goods lag behind exports due to the overly weak domestic demand within Germany. Analysts then point to weak investment activity in Germany as one of the reasons for this. With regard to the capital account, which is the mirror image of the current account balance, Germany's capital account deficits (capital exports exceed capital imports) are also said to reflect overly weak investment activity. In this analysis, current savings at the macroeconomic level exceed current domestic investment. The (savings) capital that is not used within Germany is then available to other countries instead.

For various reasons, however, the current account situation cannot be attributed to weak investment in Germany.

Internationalisation of production

German companies are extensively integrated into international production chains. This internationalisation of production goes hand-in-hand with multinational investments. These direct investments are also helpful in developing foreign sales markets. Direct investments must therefore be seen not as a substitute for domestic investment, but rather as complementing it. With regard to Germany, it is clear that increasing domestic investment often goes hand-in-hand with increasing foreign investment – and vice-versa (see figure). The overall multinational investment and value-added chain strengthens and secures production potential in all participating countries. Countries that promote this form of globalisation relatively strongly then have correspondingly high inflows and outflows of foreign direct investment. As a result of their internationalisation strategies, German companies have had a positive balance in terms of direct investment since 2004, thereby also contributing to capital accumulation abroad. In terms of the current account balance, this can then lead to a situation in which these production facilities established abroad attract domestically-produced capital goods, which in turn adds to the



current account surplus. German factories abroad are equipped with German machinery manufactured domestically.

Global investment cycle

2002 saw the beginning of an unprecedented rise in physical capital formation. By 2008, the global investment volume had doubled. The sharpest increase, at nearly 250 percent, occurred in emerging and developing countries. In the eurozone, investments doubled. In the period from 2002 to 2008, emerging economies contributed over 50 percent of absolute investment growth, resulting in an increase in their share of global investment volumes from 20 to 37 percent. After the global financial crisis, the investment boom continued in emerging countries until at least 2014, while investments in advanced countries stagnated. According to the most recent figures, each of these two groups of countries accounts for half of global investment activity. Over the entire period from 2002 to 2015, physical capital formation in emerging economies increased more than fivefold. One result was an ongoing economic convergence process for emerging and developing countries. At the same time, in periods of high demand for capital goods, countries that produce capital goods can achieve large trade surpluses. This situation is comparable with the trade surpluses accrued by countries rich in raw materials in periods of high demand and high prices for raw materials. The German trade and current account balance is historically linked to global demand for capital goods.

Adapting to demographic change

Aging populations and the anticipation of difficulties in financing social security systems tend to incentivise private savings. If some of these savings are invested abroad through net capital exports, this is then reflected in a corresponding current account surplus. The associated net international investment position (property claims on foreign capital stocks) may unravel again in the future, if domestic production and income potential is impaired because of demographic developments. Foreign savings and investments today increase the incomes of tomorrow, specifically, when labour shortages lead to decreased production and income. Firstly, this makes it possible to fill the income gaps caused by demo-

graphic change. Through net capital imports, disposable income within the country is then greater than the incomes generated by the domestic production process. Secondly, the domestic consumption of goods may then be higher than domestic production. In the future, Germany would start to record current account deficits. Thus, the current account balance also reflects intertemporal savings and consumption decisions.

Public debt

In the advanced economies, the public debt to GDP ratio rose from 72 to 107 percent in the period from 2007 to 2016. For some time now, a number of countries — including the United States — have been running so-called twin deficits, in which the government budget and the current account balance both show a deficit. The capital account surpluses that mirror the current account deficit are thus drawn upon to finance the budget deficits. This suggests that these countries should be considered to have a capital account problem rather than a current account problem, which means the current account deficit follows the capital account surplus. These countries' savings deficits require savings surpluses from other countries. The use of such resources for government expenditures, often on the consumption side, must then compete with use in investments, in all countries.