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On the EU-US Current Account

Gabriel Felbermayr and Martin Braml*

- In contrast to a substantial deficit in trade in goods with the world, the US current account displays a surplus in trade in services and primary income.
- The US has been running a bilateral **current account surplus** with the EU every year since 2009. This is because the surplus in trade in services and in primary income has exceeded the negative US trade balance. This fact gives the EU substantial leverage in trade negotiations with the US.
- The US does have a bilateral current account deficit with Germany. The focus on a single member of an integrated economic union is, however, misleading. Germany imports services from the US via subsidiaries of US companies located in Ireland and the Netherlands. These imports are not accounted for in bilateral German-US trade and balance of payment statistics.
- Current account figures provided by Eurostat substantially deviate from the mirroring US accounts. According to Eurostat, the **EU runs a current account surplus vis-à-vis the US** amounting to 170 bn EUR in 2017. Discrepancies are mostly driven by diverging numbers in primary income.
- Since most missing data is European data and information about this data provided by different European institutions is contradictory it seems more likely that the inconsistencies are mostly due to **misreporting in European data**. Given the high policy relevance, European statistical authorities should clarify this important issue as soon as possible.

The first part of this short report uses the newest available data from the Bureau of Economic Analysis (BEA), an agency of the US Department of Commerce, to analyse economic relations between the US and the EU. The data is used to decompose the components of the US current account balance, and to analyse the bilateral balance of payments with the European Union, the Euro Zone and Germany. In the second part, we use data provided by Eurostat to mirror US figures. We find enormous discrepancies between what the EU and the US report, particularly with respect to primary income.

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1 BEA Data: The Unsuspected US Surplus

Table 1 reports unambiguously that the US runs a current account deficit of 466 bn USD with the entire world. This is the result of a deficit in trade in goods of 811 bn USD, a surplus in trade in services of 243 bn USD, a surplus of 217 bn USD in primary income (defined as income from investment in foreign countries, foreign direct investment (FDI) and portfolio investment, as well as compensation of employees), and a deficit of 115 bn USD in secondary income (defined as unilateral transfers – development aid, transfers to international institutions, or remittances). So much for the US' position relative to the entire world. Table 1, however, reveals that the US has a surprisingly balanced current account vis-a-vis the European Union and the Eurozone.

In 2017, the US exported goods worth 285 bn USD to the EU and imported goods amounting to 438 bn USD from the EU. Therefore, the deficit in trade in goods constitutes 153 bn USD; this accounts for 19 percent of the total US trade deficit.

The picture changes significantly when it comes to trade in services, where US exports of 240 bn USD substantially exceed imports from the European Union amounting to 188 bn USD. Subsequently, the US have a surplus worth 51 bn USD. So, the US generates 21 percent of its worldwide surplus in trade in services with the EU.

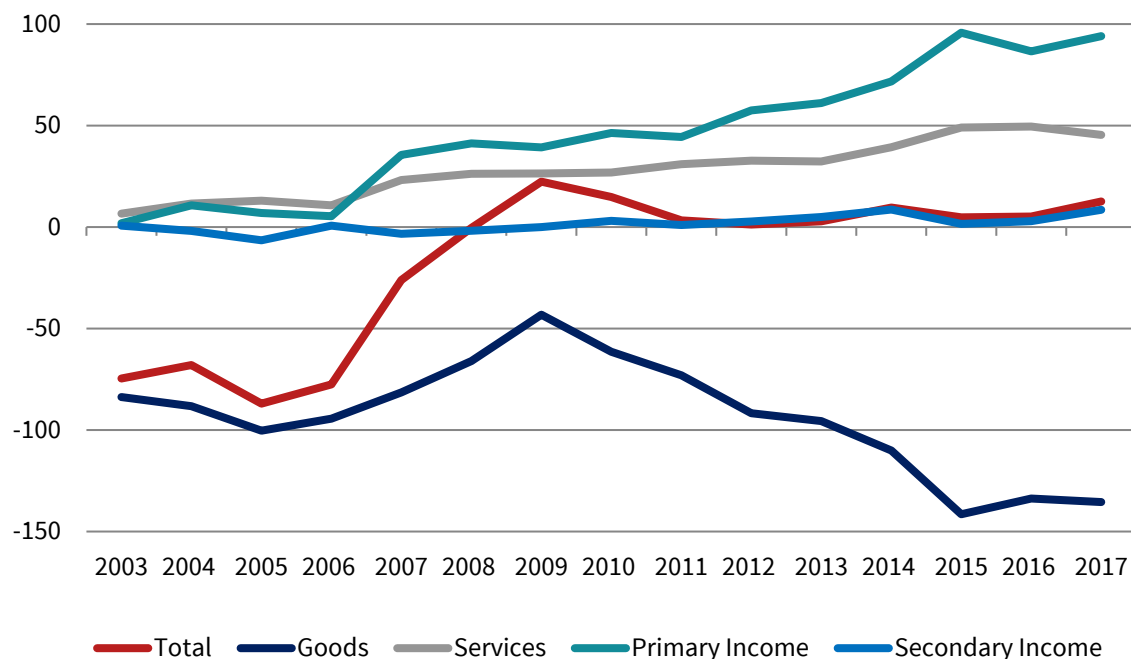
With respect to primary income, the US generated revenues of 394 bn USD in the EU in 2017. Conversely, the EU realized revenues of 288 bn USD. Thus, the surplus of the US economy amounts to 106 bn USD. In other words, US investment earns far higher returns than European investments in the US. Other components of primary income, e.g. compensation of employees, are not very important. The same holds true for secondary income.

Table 1: Subtotals of the US Current Account in 2017, bn USD, BEA data

		World	EU28	%, EU 28	Euro	
					Zone	DEU
Credit	Goods	1,550	285	18%	211	53
Credit	Services	781	240	31%	155	32
Credit	Primary income	927	394	43%	277	21
Credit	Secondary Incomes	150	43	29%	26	15
Credit	Total	3,408	962	28%	670	121
Debit	Goods	2,362	438	19%	345	118
Debit	Services	538	188	35%	120	35
Debit	Primary income	700	288	42%	199	26
Debit	Secondary Incomes	264	34	13%	23	6
Debit	Total	3,874	948	24%	688	185
Balance	Goods	-811	-153	19%	-134	-65
Balance	Services	243	51	21%	35	-3
Balance	Primary income	217	106	46%	79	-5
Balance	Secondary Incomes	-115	10	-8%	3	9
Balance	Total	-466	14	-3%	-18	-64

Source: ifo Institute based on data from Bureau of Economic Analyses, <https://www.bea.gov/iTable/iTable.cfm?ReqID=62&step=1#reqid=62&step=6&isuri=1&6210=1&6200=1>

Figure 1: Current Account Components of the US with the EU, bn USD, 2003-2017, BEA data



Source: ifo Institute based on data from Bureau of Economic Analyses, <https://www.bea.gov/iTable/iTable.cfm?ReqID=62&step=1#reqid=62&step=6&isuri=1&6210=1&6200=1>

All in all, the US bilateral current account with the EU in 2017 displays a small surplus of 14 bn US Dollar. Considering the Euro zone (instead of the EU) as counter-party, the results remain basically unchanged. The slight surplus, however, turns into a minor deficit of 18 bn US Dollar (4 percent of the global deficit of the US). In any case, the data conveys one message very clearly: if the US has an issue with its current account balance, it stems not from transactions with Europe but rather from transactions with the rest of the world.

Figure 1 shows that the US current account with Europe has been approximately balanced since 2008 and has been in small surplus since 2009. It is the result of a substantial increase of the net income of companies (balance of primary income) and the surplus in trade in services with the EU. These gains are more than sufficient to outweigh the trade in goods deficit, and ultimately lead to a positive bilateral current account from the perspective of the US.

The figures provide insights into two essential characteristics of transatlantic trade: first, the US enjoy a tremendous comparative advantage in services—e.g. IT services, business-related services, and financial services—while Europe has a highly noticeable comparative advantage in

manufacturing. Second, US companies gain much higher income in Europe than vice versa. Instead of exporting to the European market, US companies produce directly in Europe—which avoids tariffs and other trade barriers, and leads to substantially higher profits.

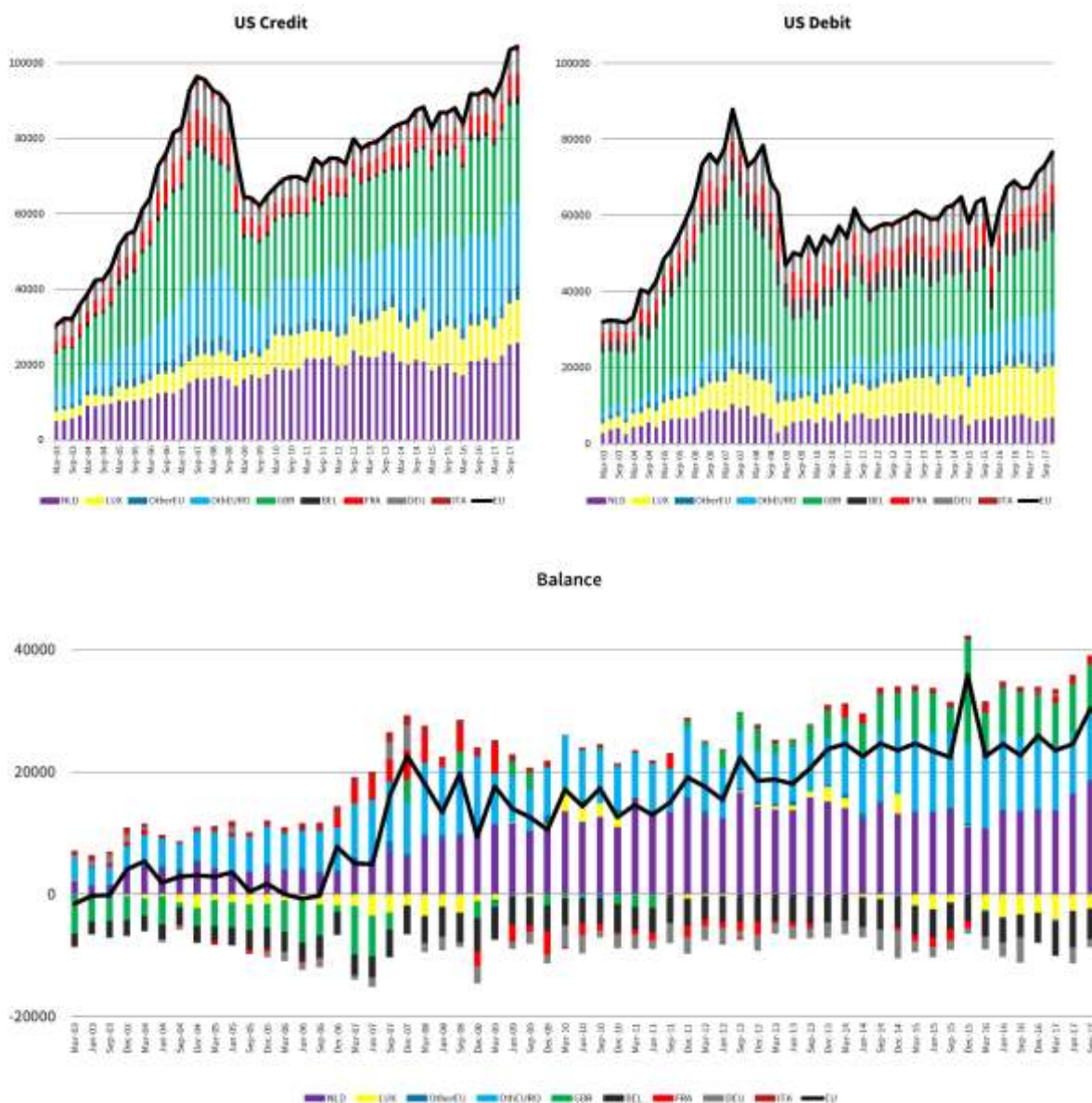
1.1 Tax planning and profit shifting distort national current accounts

Additionally, due to tax reasons (at least until the 2018 tax reform) American companies have shifted intangible goods such as patents to their foreign subsidiaries, particularly those located in Ireland and the Netherlands. Affiliates located in other European countries and all over the world, including those from the US, buy these services and pay royalties, license fees, et cetera. This shifts corporate profits to countries like Ireland and the Netherlands. Roughly speaking: due to corporate tax planning, a huge part of the US surplus in trade in services is converted into a surplus of primary income. The boom of the digital economy and the utilization of so-called patent-boxes (tax-saving schemes that are popular among some European countries) explain the increase of primary income.

Figure 2 shows the position of quarterly primary income of the US with the EU and its member states. In 2017, on average revenues worth 100 bn USD were generated in the EU each quarter, while the expenditures amount for approximately 70 bn USD quarterly. This results in a net primary income balance of 106 bn US Dollar per annum, which is already reported in Table 1.

Furthermore, the figure displays that the primary income flows mostly stem from the Netherlands, Luxembourg, so-called “Other Euro” countries (mostly Ireland, but also the Baltic countries or Malta), and the UK. The same countries also dominate the figure of expenditures for primary income, while values for Germany are not significant.

Figure 2: Quarterly Primary Income Position of the US with the EU and Its Member States, mn USD, BEA data



Source: ifo Institute based on data from Bureau of Economic Analyses.

The diagram below (“Balance”) reveals that the US surplus consists almost entirely of surpluses with the Netherlands and Ireland (“Other Euro”). This underlines the importance of the unified European Single Market in combination with significant differences in taxation between EU member states. For instance, the German market is served with US services by US companies that operate from Ireland or the Netherlands. This in turn leads to a negative bilateral German balance of trade in services with Ireland and the Netherlands, but not with the United States. Brad Setser (2018) has scrutinized the effects of tax optimized FDI activities on balance of payments statistics on the example of Ireland.

Thus, Germany enters differently in the US current account than the rest of Europe, as presented in Table 1. Hence, the US runs a bilateral deficit in trade in goods, trade in services as well as in primary income with respect to Germany; in total, the bilateral deficit amounts to 64 bn USD. Germany imports services from US enterprises via their subsidiaries in other EU member states, where the primary income for the US finally originates. In contrast, the bilateral German surplus in trade in goods reflects production networks in the EU as well. For instance, Germany runs a remarkable trade deficit with central and eastern European countries (particularly with Czechia and Hungary), which serve as intermediate good producers for the German export industry. Consequently, a part of the German trade surplus with the US is value added imported from non-German suppliers. Many economists, for instance Krugman (2013) or Bernanke (2015) have focused on the “harm” the German current account surplus does, but have its strong linkages to other countries in the European Single Market. This is the ultimate reason why bilateral current account positions need to be analysed with the utmost caution. This is particularly true with respect to individual members of the EU relative to third countries. The EU is a highly integrated economic entity with a common trade and investment policy, a common currency, and a single market. But this warning also holds generally true and is of high relevance for the analysis of bilateral relationships of the US not only with the EU but also with China.

1.2 What Do European Data Tell Us?

In principle, the figures already presented from US perspective vis-à-vis the European Union ought to mirror EU data vis-à-vis the United States by definition, merely with a reverse sign. Nevertheless, in reality numbers deviate greatly from their theoretical relationship. One possible reason for these deviations is that exports of goods are measured “free on board” (FOB), while imports are reported including “cost, insurance, freight” (CIF). As a consequence, in trade in goods, import figures reported by one country typically exceed the respective exports indicated by the trading partner.

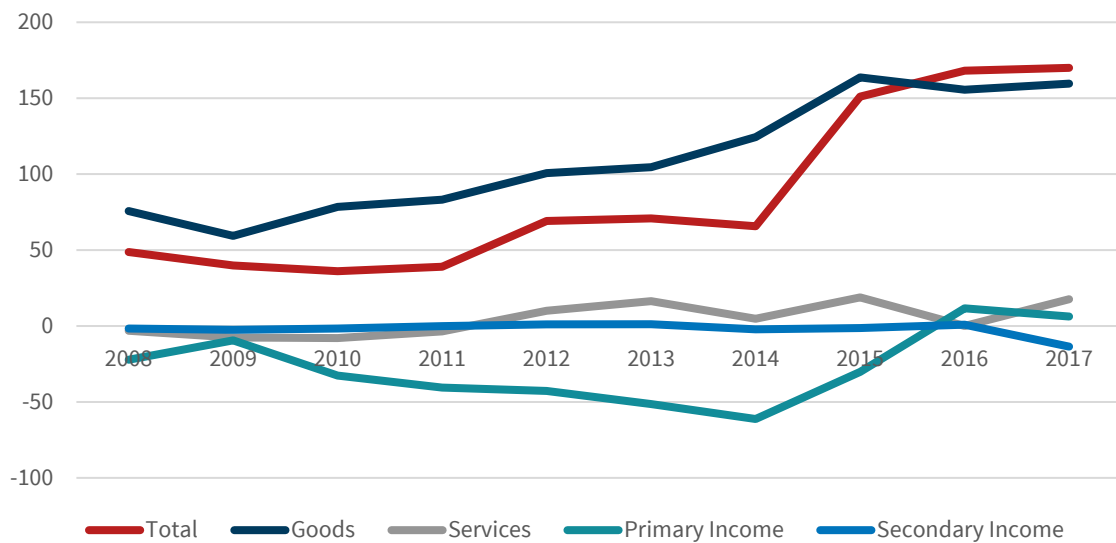
The German Bundesbank provides quite detailed bilateral balance of payments figures.¹ These numbers provide a relative good mirror image to those of the BEA with respect to US-German accounts. While there are discrepancies, signs and magnitudes of the current account positions are in line with US data. Thus, at least with Germany, national data are roughly matching BEA figures.

Eurostat data, however, are inconsistent with US data. Eurostat reports a 170 bn EUR current account surplus vis-à-vis the US, while the BEA notes a surplus for the US which accounts for 14 bn USD. Hence, the asymmetry is not only substantial but it is also politically highly relevant: if the BEA figures are correct, there will be no reason at all for the US administration to rethink

transatlantic economic relations; but if Eurostat’s numbers are accurate, Donald Trump’s “trade wars are easy to win if you are already 100 bn down” might apply.² In a report, Eurostat has scrutinized possible causes for these inconsistencies, without offering a plausible explanation.³ It enumerates well-known arguments explaining measurement error in current account positions, but fails to come up with a rationale for the astonishing extent of discrepancies between EU and US data.

Figure 3 illustrates components of the EU current account with the United States as published by Eurostat. For the period of observation, the European Union runs a current account surplus each year. Predominantly, this is driven by substantial trade surpluses (trade in goods). Exports and imports between the US and the EU in trade in services as well as in secondary income are roughly balanced while the primary income balance turned into a slight EU surplus quite recently. Subsequently, after 2014 the EU current account surplus rose by more than 160 percent. This development in combination with the total size of discrepancies between EU and US statistics are more than puzzling:

Figure 3: Current Account Components of the EU with the US, bn EUR, 2008-2017, Eurostat data



Source: ifo Institute based on data from Eurostat.

² <https://www.cnbc.com/2018/03/02/trump-trade-wars-are-good-and-easy-to-win.html> , accessed on May 14, 2018.

³ <http://ec.europa.eu/eurostat/documents/7870049/8544118/KS-GO-17-016-EN-N.pdf/eaf15b03-5dcf-48dd-976f-7b4169f08a9e>, accessed on May 14, 2018.

The US states a deficit in trade in goods of 153 bn USD in 2017, while the respective EU figure shows a 170 bn EUR surplus. COMEXT, a trade data source compiled by the EU Commission, reports numbers in the amount of 120 bn EUR. However, the overall picture points in the same direction and balances of trade in goods can be seen to be relatively congruent compared to deviations in other accounts.

With respect to trade in services, much larger asymmetries become visible: Eurostat claims an EU surplus in trade in services amounting to 17,6 bn EUR, while the BEA data report an US surplus of 51 bn USD. According to data from the World Input Output Database (WIOD)⁴, the EU deficit in trade in services is even larger totaling 102 bn USD in 2014, which is the latest available data. For the same year, the BEA reports a 52 bn USD surplus for the US and Eurostat +4 bn EUR respectively on the part of the EU. Thus, we can conclude that trade in services data are obviously much more prone to error than statistics for trade in goods. However, the team which put together the WIOD data, a consistent set of international accounts, must have dealt with the discrepancies and appears to have concluded that the EU runs a deficit in services with the US.

Nonetheless, the most severe discrepancies occur in the measurement of primary income; a US reported surplus of 106 bn USD in 2017 faces an EU reported surplus of 6 bn EUR. Unfortunately, a third data source does not exist. Interestingly, one could expect that, if statistics on trade in services and primary income do not match between the US and the EU, the biases should cancel out. As extensively discussed above, accessing markets via service exports or investment are (potentially perfect) substitutes. Hence, if one party assigns economic activities to the service account while the counterparty assigns the same activity to the primary income account, this does not affect the current account as a whole. Thus, it is worth mentioning that the asymmetries observed between EU and US figures work against this logic.

As already mentioned above, the US generate their investment revenues in only a few EU member states, mostly in the Netherlands (63 percent of their total 106 bn EUR surplus). However, the Dutch National Bank (DNB) does not publicly provide balance of payments data vis-à-vis the United States. Besides an acknowledgement of receipt, a data request of the authors remained unanswered by the DNB up until now.

The European Central Bank collects bilateral balance of payments data from its 19 national central banks. Unfortunately, only incomplete EMU (European Monetary Union) current account balances vis-à-vis the US on primary income are published. More precisely, the primary income account consists of 5 sub-accounts⁵, but only the credit side is accessible for all of them. The debit

⁴ The WIOD (World Input-Output Data) Project has been financed by the European Commission. See <http://www.wiod.org/home> for details.

⁵ Compensation of Employees, Investment Income/FDI, Investment Income/Portfolio Income, Investment Income/other, and Other Primary Income.

side of the Portfolio Investment account is missing. Due to this fact, no balance on primary income can be calculated; the same is true for the current account of the EMU vis-à-vis the US. Interestingly, the mirror account in US data amounts to 83 bn USD, or 105 percent of their surplus in primary income vis-à-vis the EMU. Hence, the missing account is far from being irrelevant.

Upon request, the ECB informed the authors that the “compilation of portfolio investment liabilities follows a different approach” than the standard reporting by national central banks. “In practice, it is difficult for national compilers to identify the residency of the holders of securities issued by euro area residents. This is because these instruments are openly traded in secondary markets and often transacted/held via intermediaries resident in the euro area on behalf of their non-resident clients.” Further inquiries have not led to substantially different answers. However, according to the ECB, they are currently working on a new method for calculating portfolio investment liabilities.

Certainly, the remarks by the ECB are, of course, plausible in the aspect that secondary market transactions, cross-shareholding, and the determination of ultimate source of ownership severely affect data accuracy on primary income. Nonetheless, the ECB’s answer raises the following questions:

1. Eurostat is able to collect data from national statistical offices on the primary income balance vis-à-vis the United States. Hence, they either have found a way to overcome the aforementioned obstacles, or they simply ignore them.⁶
2. The Bureau of Economic Analysis must face the same problem; seemingly, they have found a way to overcome these issues, or they simply ignore them.
3. Apparently, the ECB is confident to geographically disclose positive portfolio income (credit account). Applying the same logic with respect to secondary market transactions, how can national compilers be certain about the location of their debtors? Moreover, applying the same logic to Income on Foreign Direct Investment (FDI), how can national compilers be assured about the location of their debtors/ creditors?
4. Upon request, the German Bundesbank confirmed that they are able to provide geographical breakdowns for all sub-accounts of the German balance of payments including primary income. They have geographic information on all counterparties but refer that these counterparties may not be the ultimate owners. However, ultimate ownership is not of primary interest; analogously to trade in goods, exports do not necessarily reflect the origin of value added. Hence, the current account statistics will only be consistent, if they ignore these issues.

⁶ The authors were told by Eurostat upon request that they compile data provided by national statistical offices. They did not provide access to a national breakdown of their bilateral current account data up until now. They did not either confirm the completeness of their data (meaning that have received all information from their 28 member states)

Summarizing the situation, we seem to have identified a puzzle, namely the primary income puzzle. Without complete access to a complete set of bilateral data from the ECB or national central banks, we cannot finally assess the transatlantic economic relations. So far, the most comprehensive as well as consistent data available are those from the BEA. Moreover, the BEA does not have to compile data from 28 national statistical offices and central banks, thus their data are less likely to be error prone.

1.3 Mercantilist Bias and the Question of “Cui Bono”

Modern macroeconomists do not necessarily favor current surpluses, nor do they disapprove of deficits. Current account positions are the direct consequence of intertemporal consumption, investment and saving decisions, and they often reflect varying national savings rates. Moreover, exchange rate effects, more precisely the dollar privilege, heavily impact the US current account. However, mercantilist views in favor of current account surpluses are still very much present. Often enough, the wording is more than revealing. A current account *deteriorates* if its balance shrinks; it *improves* if its balance increases. Hence, officials as well as statistical offices may have a bias towards overreporting their net foreign trade statistics. Such a mercantilist bias would be symmetric across trade partners and explain the inconsistent finding that both partners report surpluses.

However, the question of “cui bono” (who benefits?) is still worth being raised in this respect: Who could potentially benefit from higher current account figures?

1. Does overreporting beyond the mercantilist bias help the United State? The answer is quite clear: it does not. The US provoke a trade war justified by allegedly “unfair trade practices” on the side of their European trade partners. Disclosing a current account surplus, by contrast, the BEA undermines the White House bargaining power and counteracts their line of arguing. Hence – if at all – the US has an incentive to underreport their current account vis-à-vis the European Union but not to overreport.
2. Does overreporting beyond the mercantilist bias help the EU? It is not obvious to us how the EU could benefit from the self-reported current account surplus of 170 bn EUR. Particularly in a situation when being accused of applying “unfair trade practices”, there should be no incentive to overreport current account statistics. Scope for potentially misleading statistics with respect to primary income might exist at the national level. The existence of highly negative primary income balances of only a few countries vis-à-vis the US is grist to the mill of all those who criticize the Netherlands or Ireland for their corporate tax practices. Consequently, these countries may have an incentive to underreport investment income liabilities. Hence, methodological drawbacks may prevent these countries from politically sensitive debates. Indeed, we have found evidence that part of the puzzle lies in missing Dutch data.

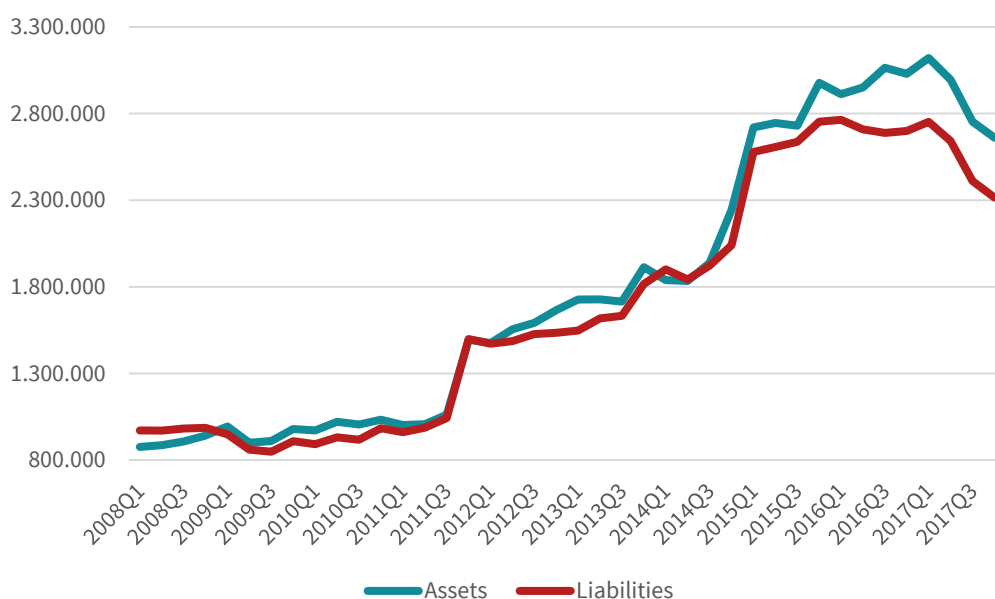
1.4 Net Foreign Asset Positions of the EU and the US

As a direct consequence of permanent current account deficits over the past decades, the US became a net-borrower from the rest of the world. This means, US liabilities against foreigners exceed US assets abroad. Despite their negative net investment positions amounting to almost 8 trillion USD according to the IMF⁷ in 2017, the US generates a surplus in their primary income balance (+217 bn USD). Potential reasons are already provided by Eichengreen (2006), Gourinchas and Rey (2007), and others. Multiple reasons – ‘dark matter’, ‘savvy investors’, ‘venture capitalist of the world’, ‘dollar privilege’, ‘maturity transformer of the world’ – might interplay and are mutually reinforcing. Ahmed et al. (2018) argue that the US earn high primary income through a greater share of equity investment abroad compared to foreign investment in the US (this relates to both FDI and portfolio investment). This is not subject of the analysis in this paper, but assuming higher return rates for US foreign investment allows for an assessment whether the US primary income surplus vis-à-vis the EU seems plausible. According to IMF data, the Eurozone is a net debtor to the rest of the world as well, but to a much lesser extent than the US. Gross assets of 30,7 trillion USD and liabilities of 31,3 trillion USD yield net asset positions of -600 bn USD.

Data on bilateral investment positions are rarely available; for instance, Eurostat data does not cover all countries, and also the time dimension (four years) limits a deep analysis. The ECB, by contrast, provides bilateral FDI statistics, not for the EU as whole but for the Monetary Union. In 2017, the EMU holds FDI of 2700 bn EUR in the United States in contrast to 2400 bn EUR US FDI in the EMU. Figure 4 illustrates the bilateral FDI stocks for the EMU and the United States. Foreign direct investment can be further subdivided into “Equity and investment fund shares” and “Debt instruments”. The latter accounts for 30 percent of total EMU FDI assets and 40 percent of EMU liabilities vis-à-vis the US. Interestingly, the total FDI stocks are perfectly correlated (the correlation coefficient yields 0,99).

⁷ Data access via <http://data.imf.org/?sk=7A51304B-6426-40C0-83DD-CA473CA1FD52&slid=1409773422141>, May 17 2018.

Figure 4: EMU FDI Positions vis-à-vis the US, mn EUR, 2008-2017



Source: ifo Institute based on ECB data.

Table 1 compares ECB data on FDI with the respective mirror accounts of the BEA. Please note that due to methodological issues, different levels may also reflect different valuation methods (historical cost base vs. fair value). Thus, it is more meaningful to compare relative numbers (within one data source). The discrepancies are, again, astonishing: both parties report positive net asset positions with the counterparty. Moreover, both parties provide evidence that they yield higher returns than the counterparty. Hence, we can conclude that the primary income puzzle is not only limited to returns but includes also valuation of the underlying assets.

Table 1: Comparison EMU-US FDI Stocks, Returns, and Return Rates, 2016

Reporter	ECB		BEA	
	EMU Assets	EMU liabilities	EMU Assets (US liabilities)	EMU Liabilities (US assets)
FDI Stock (bn)	2.989 EUR	2.715 EUR	1.601 USD	2.171 USD
Absolute Return (bn)	59 EUR	17 EUR	73 USD	169 USD
Return Rate (%)	1,97	0,01	4,5	7,8

Source: ifo Institute on basis of ECB and BEA.

Note that absolute returns are taken from the Primary Income Account.

With respect to portfolio investments, a further analysis fails due to missing data on the side of the ECB. Data on EMU portfolio investment assets vis-à-vis the US are complete and allow also for a distinction between equity and debt investments but data on liabilities are missing. Hence, we cannot impute EMU portfolio income debits (the missing account in the BoP statistics) by assuming a bunch of potential return rates. This could have helped dissolving the primary income puzzle.

1.5 Concluding Remarks

This short analysis has focused on bilateral balance of payments statistics between the US and the EU. First, we have emphasized that according to official US data, the United States run a small current account surplus vis-à-vis the EU. Due to different business models (manufacturing oriented EU export industries versus US service providers investing abroad) in combination with tax avoidance strategies within the EU, US current account figures vis-à-vis members of the European Single Market are economically meaningless. Thus, we recommend not being too concerned about bilateral current account statistics vis-à-vis EU member states.

Secondly, we have shown that EU balance of payments statistics substantially deviate from the US mirror data. This refers to trade in services and, to an even greater extent, primary income.

Third, our investigations and inquiries to the ECB, Eurostat, and different EMU central banks could not clarify how European figures are compiled. Responses by the mentioned institutions are even contradictory. The ECB fails to provide information on an account⁸, for which US counterparties book 83 bn USD. Due to this unsatisfying information base, no final conclusion can be drawn. Nevertheless, a comparison of US figures with respective German Bundesbank data points towards the credibility of US data.

⁸ Primary Income/Investment Income/Portfolio Investment/Debit.

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- 3) capital markets and the regulation of the financial sector and
- 4) governance and macroeconomic policy in the European Monetary Union.

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