Summary for non-specialists
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Economic Papers index

# The Dutch current account balance and net international investment position

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The Dutch current account has been persistently in surplus for over three decades and the surplus is currently one of the highest, expressed as a percentage of GDP, in the euro area. The aim of this paper is to shed light on the driving forces behind the Dutch current account surplus from various angles, in order to assess the likelihood of the persistence of the surplus, and to help identify any policy measures that may be called for.

Section 2 breaks the current account down to its components and shows that the surplus in the trade of goods is the main factor behind the surplus, increasingly due to the contribution of so-called re-exports (goods which leave the country again after some added value from processing). This reflects the Dutch economy linking into global production chains and benefiting from locational factors and a competitive edge in adding even a small percentage of value added to the large flows of goods channelled through the Dutch territory. Given the sheer volume of the trade flows, the share of net exports accounted for by re-exported goods is increasing. By contrast, relative market shares for domestically produced exports, originating notably in industries such as foodstuffs and chemicals, have developed less favourably. Overall however, the competitive position of the Netherlands underpinning the trade surplus appears to have remained quite strong.

Section 3 zooms in on sectoral savings balances in order to examine to what extent spending and saving decisions of households, firms and the government have been driving the current account surplus. Despite the fact that the Netherlands is a high savings economy with a high level of institutionalised pension savings (for a large part channelled abroad), households saw their net savings move towards negative territory around the early 2000s, a shift that reflects to a large extent the pivotal role played by the housing market. Tax incentives, developments in the labour market, and financial innovations in mortgage lending were all instrumental in the progressive leveraging of households against housing wealth since the mid-1990s. This sizeable shift towards mortgage lending also importantly impacted the portfolio allocation and funding of banks. The households' saving-investments turnaround was mirrored by the non-financial corporate sector, which moved into structural surplus as net household savings dwindled. This shift of Dutch corporations from borrowing funds to running financial surpluses reflected a host of factors, notably high profitability, mainly spurred by increasing profit shares received from foreign operations. This may well have partly been triggered by the favourable tax treatment of repatriated foreign income in the Netherlands. Finally, the government balance has been relatively contained over cyclical swings.

Section 4 examines the financial account, describing the financial transactions mirroring the current account surpluses, in order to signal macro-financial vulnerabilities. It turns out that the importance of multinational enterprises operating from the country and certain attractive features of the corporate tax system have induced substantial gross inward and outward financial flows, which are partly channelled through so-called Special Financial Institutions. But since these institutions do little else than channel funds, their external claims and obligations broadly cancel each other out and the impact on the overall external balance appears to have been very limited. On balance, the role of the Netherlands as a hub of international financing flows thus does little in terms of offering an explanation for the persistent external surplus. However, the financial account is characterized by increased volatility and size of financial flows with both inward and outward foreign investment figuring prominently.

Turning from flows to stocks in section 5, in the atypical case of the Netherlands, the gains in the reported net international investment position (IIP) were much smaller than would have resulted from the accumulation of past current account surpluses. Negative valuation effects, stemming from exchange rate and market price changes, have contributed to dampening the positive effect of the current account surplus on the net IIP. Composition effects may have played an important role. The picture of the stock-flow linkages is moreover blurred by several statistical issues, notably accounting-related underestimations of the net IIP due to disparities between market and book value of foreign participations, and further complicated by profit transfers within multinational enterprises to tax-favourable destinations. Hence, a fair degree of caution is warranted when comparing and interpreting balance of payments flows and changes in the net IIP.

Since the current account of a country can be interpreted as the ultimate reflection of all aspects of its economy, it should not be considered a policy variable to be targeted directly. In this sense, univocal policy conclusions do not emerge from the analysis from multiple angles carried out in this paper. However, the structural mismatches (in terms of maturities, exposures etc.) of Dutch assets and liabilities and concurrent funding problems have made the Dutch economy volatile and dependent on the whims of international capital markets. This raises the risk of sharp deteriorations in balance sheets in some sectors of the economy, through large-scale portfolio shifts, flight-to-quality, and write-downs on large foreign investments. The ensuing negative feedback loops from the current account to the real economy are also posing a severe challenge to government accounts, notably to corporate tax revenues. Against this backdrop, a fundamental reflection on the optimal investment strategies of the proceeds of the accumulated surpluses as regards savings-investment patterns and the balance between home and foreign investment may be called for. Moreover, fairly sluggish productivity increases in the most recent period and the low value added of re-exports imply that policies should remain focused on fostering innovation and competitiveness. Finally, in addition to an overhaul of the institutional setting of pension funds, strong measures to address a far-reaching reform of the housing market are already long overdue.