

The German surplus is still a problem for the euro area and the world

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On 13 November, the European Commission announced that it would examine whether Germany's current account surplus could lead to a reduction in economic growth in the euro area. This decision is the result of a debate on Germany's heavy reliance on exports, a discussion which intensified after the US Treasury Department indicated that Germany's surplus is one of the causes for the slowdown in economic growth in the euro area. Since 2011 the European Commission has had the power to impose financial penalties on countries that exhibit macro-economic imbalances and do not seek to correct them. Germany has recorded a significant trade surplus for many years, while continuing to argue that self-correction will take place in the future. It remains unclear whether this time international pressure will force Berlin to take concrete steps to boost domestic demand. Germany is concerned that any significant increase in government spending (such as wage increases) could lead to a loss of its competitive advantage, which in recent years has allowed its exporters to record the highest sales levels in German history.

The essence of the problem

The problem of the current account imbalances has been the subject of intense debate by economists during the crisis. The conclusion is that either excessive surpluses or deficits in relation to GDP could destabilise the global economy. The high current account surplus (excluding the situation in countries dependent on exports of raw materials) may be caused by weak domestic demand, meaning that a country imports less. The second possibility is that the country is not an attractive destination for investment, which means that trade surpluses are not invested on the domestic market, but outside the country.

Last year, Germany recorded a surplus of 7% on its current account deficit. In absolute terms, it rose to almost US\$240 billion, about 24% higher than China's surplus. Other countries claim that Germany's significant imbalance between exports and imports means it benefits to a greater extent from world trade than other countries do, thus generating more jobs and greater prosperity for Germany. The last decade has seen a rapid growth in exports and considerably slower growth in imports in Germany, hampered by the long-term stagnation of domestic demand. The state has limited spending in order to reduce the budget deficit, and for this reason the level of investment in relation to GDP in Germany is the second lowest in the EU, after Austria. Meanwhile consumers have limited their spending, in fear of the consequences of the demographic decline and of the reforms

reducing social security benefits which have been implemented in recent years. This domestic situation has forced German manufacturers to look to foreign markets; this was facilitated by the stable exchange rate of the euro, which was less vulnerable to currency appreciation. As a result, Germany began to record a significant surplus in its current account. However this surplus was not invested domestically, but mainly in purchasing junk bonds on the US housing market, and financing the borrowing needs of other euro area countries.

Germany has defended its economic model, portraying its growing surplus as a sign of its economy's competitiveness. They accuse other countries of being jealous of German success, and of hoping that Germany will push its businesses to artificially reduce their advantages. That would mean that the long-term savings and sacrifices associated with social reform and the reduction of social benefits would all have been for nothing. Germany also argues that its citizens cannot be forced to increase their spending, and only an economic situation which remains stable in the long term will encourage them to consume more.

The political debate on Germany's trade surplus

The problem of Germany's current account surplus began with the creation of the euro area. In the 1990s, as a result of the rising costs associated with the unification of the country, Germany systematically recorded a current account deficit. The euro radically changed the situation, and as of 2006 Germany began to see a significant trade surplus, running at 5-6% of GDP. In 2010, the discrepancy amounted to US\$206 billion dollars, and only China's surplus surpassed it. It was not until after the start of the eurozone crisis in 2010 that attention was focused on this problem for the first time. Christine Lagarde, the then French finance minister, concluded that Germany's excessive exports, together with its relatively slower growth in imports, was an expression of a selfish policy which created problems for other countries in the monetary union. Similar allegations were made in the same year by the US Secretary of State Timothy Geithner, who at the G20 forum described the policies of Germany and China as bad for the economies of other countries in the world.

Germany only partially acknowledged these arguments, and agreed to reduce its surplus by stimulating domestic consumption, believing that this would automatically reduce the disparities. Also, under pressure from other European countries, Germany finally agreed that the new procedure for supervising macroeconomic imbalances, which the European Commission was supposed to carry out annually, should include a limit of 6% on the current account surplus. Countries which are under obligation to revise their surpluses must make the appropriate adjustments on pain of a financial penalty of up to 0.1% of GDP, which in Germany's case could mean a fine of up to €2.6 billion.

Despite numerous assurances, Germany has done little to reduce its surplus, yet it has been the main proponent of the policy of savings as a way to bring the eurozone crisis to an end. Although Germany introduced stimulus packages in 2009-2010, these were *ad hoc* measures. The improved economic situation also brought slightly higher growth in domestic consumption with it. However, this did not put a stop to the surplus, as its high level was supported by a partial reorientation of German exports to fast-growing emerging economies. Moreover Germany's energy policy, which is based on ensuring its

independence from energy imports by the rapid development of renewable energy sources, is unlikely to reduce the surplus. In the absence of decisive action from Germany, the US State Department criticised Germany's growing current account surplus in October, and demanded a correction of the imbalance. On 13 November, the European Commission decided to examine whether the surplus in the current account would lead to a destabilisation of the situation in the eurozone.

The international context of Germany's actions

It seems that Washington and Brussels have deliberately raised the issue of German surplus at this time in order to influence the coalition talks in Germany. Before the German parliamentary elections, Chancellor Angela Merkel promised to take measures to increase domestic consumption: reducing taxes for families, mitigating tax inequalities and increasing spending on infrastructure. European countries and the United States expect Germany to keep these promises; in the current budgetary situation, and in the light of its ever-increasing tax receipts, Germany can afford to increase its spending. However, in the case of economic downturn, a problem may arise from the 'debt brake', a mechanism enshrined in the German constitution which will force the government to reduce the structural deficit to 0.35% of GDP in 2016. Germany has met the conditions of this mechanism for the last two years.

Washington and Brussels may also be aiming at limiting German assertiveness in pushing for austerity policies. By doing so, the United States may be hoping to limit discussions about their own budget problems. The US may also fear that the policy of reducing spending in the currency union will lead to a current account surplus in the euro area in relation to the rest of the world. Until now, Germany's surplus has been offset by deficits in the southern states of the euro area. This is also an important factor in the context of the conclusion of the EU/US free trade agreement. If Germany continues its current policies, the US could deepen its already substantial current account deficit in the coming years after the free trade zone is created.

Some eurozone countries want to put pressure on Germany in order to limit its promotion of austerity policies, and to strengthen the position of the Social Democrats in coalition talks. It seems that there will be no significant reduction in Germany's surplus unless the German government takes specific action. As a result, other eurozone countries, faced with problems of solvency and spending cuts, will not be able to count on the commercial benefits of the good economic momentum in Germany. If the Germans do not review their model, the integrity of the euro area may be difficult to maintain; the eurozone does not contain any suitable mechanism for redistributing income, and being unable to control the exchange rate of their currency, the countries of the south will have difficulty maintaining their competitiveness against Germany.