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The German Current Account: A Comparison of American and European Perspectives and Policies

Abstract

This paper reviews the components of the current account balance, the historical trends of Germany's current account, and compares Germany's current account to others across the world. It then discusses factors contributing to the current account surplus, including savings and investment behaviors, interest rates and the euro, and the gap between exports and imports. After discussing the impact of the surplus on international political relations and the political environment within Germany, this paper then delves into American, European, and German perspectives of the surplus – if it is harmful to the Eurozone and the global economy, and if so, what reforms should be implemented. Finally, this paper forecasts the decline of the surplus over the next decade, and offers analysis of future trade policies in Germany, Europe, and the United States that may impact the current account balance. This paper then offers conclusions and references.

Keywords

germany, current account surplus, international trade policy

Disciplines

Business | International Business | International Economics | International Relations | Political Economy

THE GERMAN CURRENT ACCOUNT

A comparison of American and European perspectives and policies

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ABSTRACT

This paper reviews the components of the current account balance, the historical trends of Germany's current account, and compares Germany's current account to others across the world. It then discusses factors contributing to the current account surplus, including savings and investment behaviors, interest rates and the euro, and the gap between exports and imports. After discussing the impact of the surplus on international political relations and the political environment within Germany, this paper then delves into American, European, and German perspectives of the surplus – if it is harmful to the Eurozone and the global economy, and if so, what reforms should be implemented. Finally, this paper forecasts the decline of the surplus over the next decade, and offers analysis of future trade policies in Germany, Europe, and the United States that may impact the current account balance. This paper then offers conclusions and references.

Keywords: Germany, current account surplus, international trade policy

INTRODUCTION

The German current account balance has been growing since 2001, surpassing eight percent of German GDP in 2016 and clocking in as the world's largest current account surplus. European leaders, the European Commission, the IMF, and the OECD have pressured Germany to reduce its surplus for years, arguing that a reduction of the surplus is necessary for peripheral Eurozone countries to reduce their deficits. The German government consistently refutes claims that its surplus is harmful to the Eurozone or the global economy, arguing that the surplus is a result of the competitiveness and quality of German goods.

The long-smoldering debate has been rekindled following the election of Donald Trump, as his administration threatens Germany for their trade balance and accuses the state of exploiting the euro. American, European, and German economists, business leaders, and news sources have weighed in on the surplus, discussing its social and economic impact and proposing various reforms to reduce it. This paper first discusses factors contributing to the growth of the current account surplus, including savings and investment behaviors, monetary policy and the euro, and the gap between exports and imports. After discussing the impact of the surplus on Germany's political relations with the United States, the European Union, and international relations and impact on the political environment within Germany, this paper then delves into the American, European, and German perspectives. It notes that the debate does not merely pit Germany against the world – there are indeed many Germans that believe the surplus is an issue, as well as some Americans and Europeans that do not believe it is a problem.

Finally, this paper discusses the future of the German current account balance. It forecasts the decline of the surplus over the next decade, and offers analysis of future trade policies in Germany, Europe, and the United States that may impact the current account balance.

The two most impactful variables with regards to the current account are the recent German election and the future of Trump's trade policies. This paper then offers conclusions and references.

THE GERMAN CURRENT ACCOUNT: AN OVERVIEW

What is the current account?

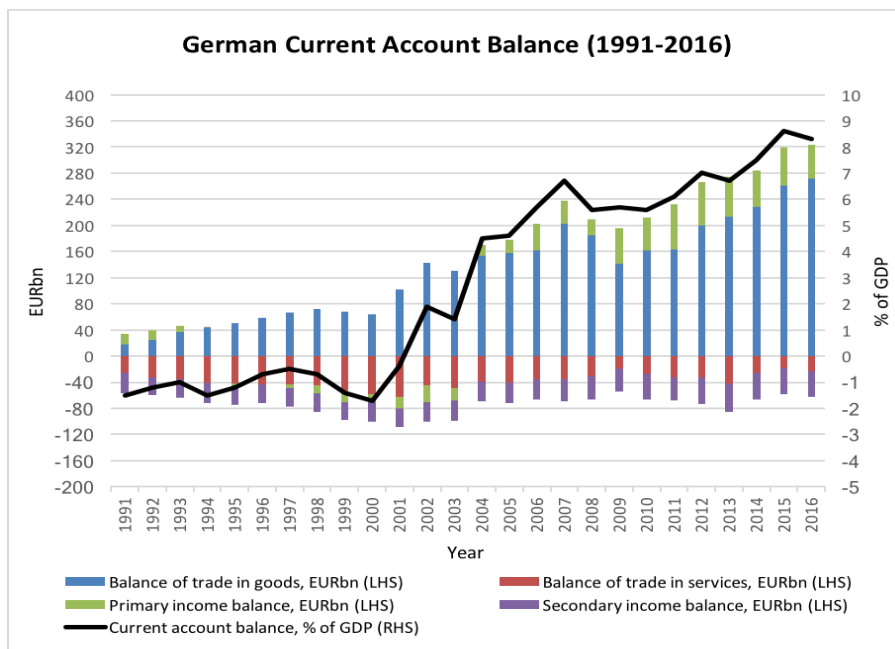
There are four main components of the current account: balance of trade in goods, balance of trade in services, primary income balance, and secondary income balance (BMI Research and Eurostat 2017). Balance of trade in goods refers to the net exports of goods, while balance of trade in services refers to the net exports of services. If the total balance of trade (sum of goods and services) is positive, there is a trade surplus; however, if the total balance of trade is negative, there is a trade deficit. The next component is the primary income balance. The primary income balance represents the net flow of income associated with income-related investments, dividends, salaries and wages paid by domestic institutions. The last component is the secondary income balance, otherwise known as net transfers. Net transfers represent the net flow of income associated with public and private aid, remittances, investment income, insurance, and other private transfers between residents and non-residents. The current account balance is the sum of the balance of trade in goods, the balance of trade in services, the primary income balance, and net transfers. If the total sum is positive, there is a current account surplus, and if the total sum is negative, there is a current account deficit.

This paper will discuss the German current account surplus and its associated figures. As the primary income balance and net transfers are relatively low and constant figures, the current account balance is often discussed as merely the balance of trade in goods and services, or net

exports. Therefore, the terms “current account surplus” and “trade surplus” are often used interchangeably. Sources cited in this paper may use both terms.

What are the historical trends of Germany’s current account balance?

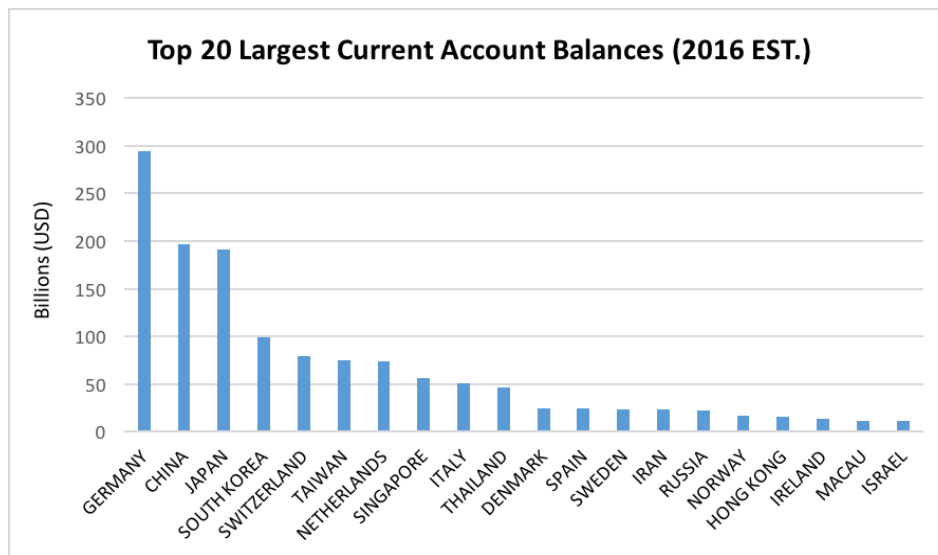
West Germany heavily invested in its economy in the post-war years as much of the nation’s public infrastructure was demolished in WWII. For several decades, Germany imported and exported almost equally. By the 1980s, domestic investment declined as reconstruction subsided. However, West Germany emerged as a leading economic power, known as the *wirtschaftswunder* (“economic miracle”). As the growth rate for West German GDP rose to 3.7% in 1988, exports continued to grow (Bond-Powell et. al 2005). This created a large current account surplus for West Germany. When Germany reunified in 1990, investment in the domestic economy picked up once again, as East Germany had to be rebuilt. This created a current account deficit between 1991-2001. Since 2001, the German current account surplus has continued to grow, and now stands at approximately 8.3% of Germany’s GDP (2016 est.).



Source: BMI Research and Eurostat data

How does Germany's current account balance compare to other countries?

The global average current account balance was approximately +1.4 billion USD in 2016 (The Central Intelligence Agency 2016). While Germany had the largest current account surplus in the world at 289.2 billion USD, the United States had the largest current account deficit at (-481.2) billion USD (The Central Intelligence Agency 2016). Germany's current account balance is about 1.5 times the size of China's, which is the second largest current account balance in the world.



Source: The Central Intelligence Agency data

FACTORS CONTRIBUTING TO THE CURRENT ACCOUNT SURPLUS

Savings and investment

The simple macroeconomic formula savings less investment, otherwise known as the net capital outflow, is equal to the current account balance. A trade deficit is the additional borrowing that a country does to finance the gap between investment and domestic saving,

whereas a trade surplus is the additional lending that a country provides those with deficits to help them finance this gap (Olivei and Dreyer 2000).

Germany has a current account surplus, partially due to its high savings rate. This is often attributed to the aging population in Germany, an increase in corporate profits, and the prudent German culture. By 2035, Germany will have more than 21 million inhabitants over the age of 67 and half of them will be over 80 by 2050 (Heise 2017). If longevity rises faster than currently expected, this age group will be even larger. These demographic factors account for about a third of the 8.3 percent current account surplus (Fratzscher, "Germany's Misunderstood," 2017). As these individuals save for retirement, private corporations and the government are saving more as well in expectation of an older, smaller population. The government budget surplus was 23.7 billion euros, or about 25 billion dollars in 2016, as it saves for the projected decline in pension contributions and growth in healthcare costs as the population ages (Handelsblatt Global Staff, "Germany Banks," 2017). Low wages have also pushed down the labor share of national income, meaning that firm profits have increased. Since firms have a lower propensity to consume, this has also increased the savings rate. German national savings grew from about 21 percent of GDP to 28 percent from 2003 to 2017 (Jacoby, "President Trump," 2017). Beyond these factors, Germany is also known for having a culture of prudence. This is a remnant of hyperinflation after WWI, when German banknotes became essentially worthless, forcing Germans to save every cent. Today most Germans pay solely with cash to avoid accumulating debt. Many stores and restaurants do not even accept credit cards. Germany has often been criticized for this prudence, especially with the austerity measures it imposed on struggling European countries during the Eurozone crisis.

In addition to having a high savings rate, Germany has a low domestic investment rate. This gap is the current account surplus; if Germans invested as much as they save the current account would be balanced. There are two types of investment: public investment from the government and private investment from corporations. Germany has one of the lowest public investment rates in the industrialized world at just 2.1% of GDP in 2016 (Federal Ministry of Finance 2017). Germany has been criticized for spending so little on investment in infrastructure while simultaneously running a budget surplus. However, public investment has been rising at an annual growth rate of 3.8% since 2005, and the German Federal Ministry of Finance expects it to grow by an annual average of 5% in the coming years (Federal Ministry of Finance 2017). The government has also begun reforms to boost federal states' and local authority's investment and investment capacity. This is a positive step for Germany, as its municipalities, which are responsible for half of all public investment, currently have unrealized investment projects worth 136 billion euros or 4.5 percent of GDP (Fratzscher, "Germany's Misunderstood," 2017).

Private domestic investment, which makes up 90 percent of investment in new projects in Germany, has also been weak as corporations invest abroad (Handelsblatt Staff, "Surplus of Envy," 2017). Many attribute this to regulation of the non-tradable services sector (i.e. services where the consumer and producer must be in the same location such as construction, utilities, hotel accommodation, real estate, and local transportation) and the tax structure. According to Marcel Fratzscher, the head of the German Institute for Economic Research, "The IMF, EC, and OECD have long tried to convince Germany to deregulate services, curtail vested interests, and improve competition. But as it stands, wages, productivity and investment remain high in the German export sector, and low in the non-tradable services sector" (Fratzscher, "Germany's Misunderstood," 2017). Despite these factors, the current rate of overall investment (public and

private) is likely to increase slightly this year from 20 to 20.2 percent in relation to GDP (Böcking and Reiermann 2017).

Instead of contributing to investment, much of the savings go abroad, where foreigners recycle the money to buy German goods. Many economists are concerned that this large outflow of capital forces other countries to have deficits, higher consumption rates, and higher unemployment. However, there is also concern that this outflow of capital harms Germany. The German Economics Ministry recently expressed concern about this outflow of capital, because as the amount of money trading partners owe Germany grows, so does Germany's claim to an increasing share of the future output of the global economy (Handelsblatt Staff, "Surplus of Envy," 2017). Thomas Mayer, Director of Research at the Flossback von Storch Research Institute, says, "For every euro generated by the surplus, around 30 cents are lost. That's capital needed at home. It weighs on potential growth and thus prosperity of Germany" (Handelsblatt Staff, "Surplus of Envy," 2017).

The euro and interest rates

One cannot discuss the current account surplus without discussing the Euro. By using the Euro, Germany loses the most important traditional lever for bringing their economy back into balance. If Germany had its own currency and there was high demand for Germany's products, the demand for German currency would increase. The real exchange rate would appreciate, making German goods more expensive for foreigners, and demand for German products would decline. Foreign goods would become cheaper for Germans, so imports would increase. Lower exports and higher imports would decrease net exports, therefore decreasing the German current account surplus. However, Germany uses the Euro. The Euro is designed reflect the economic

strength of all countries within the Eurozone, including struggling economies in southern Europe, so it is undervalued for Germany. The IMF says Germany's real exchange rate is now 10-20% undervalued (International Monetary Fund 2017). Since the Euro is undervalued, German goods are cheap for foreigners. This increases demand for German goods, and therefore increases Germany's exports. However, the Euro will not adjust to bring the German economy back into balance as a German currency would because it is brought down by the weakness of struggling southern European economies. Therefore, Germany will continue to have high exports and low imports.

Interest rates also contribute to the current account surplus. While ECB interest rates are still close to zero in an effort to boost struggling southern European economies, the Federal Reserve raised the target range for the federal funds rate for the second time this year to 1.00-1.25%, due to strong U.S. economic growth and low unemployment rates (Board of Governors of the Federal Reserve System 2017). With higher interest rates in the United States, the dollar will appreciate against the euro. The cost of American goods will rise, whereas the cost of European goods will fall. This will inflate the German current account surplus. Germany's finance minister, Wolfgang Schäuble, has criticized the European Central Bank for this loose monetary policy, stating that their policies prevent Germany from lowering its surplus (Reiermann and Sauga 2017). However, the ECB must consider the economies of all member states, and cannot tighten monetary policy due to struggling economies in Southern Europe.

Many German leaders like to use the euro and ECB monetary policy as a scapegoat, saying they cannot do anything to change the current account surplus because they do not control exchange rates or interest rates. However, there are many other causes for the German current account surplus as previously pointed out, some of which are directly controlled by the German

government, like public investment, tax structure, and regulation of the non-tradeable services sector.

High exports, low imports

Lastly, Germany has a very low level of imports relative to its level of exports. High levels of exports are not a bad thing for Germany or the global economy. However, the gap between exports and imports leads to a surplus in the balance of trade in services and goods, and therefore a current account surplus. With German goods being undervalued, a lower level of imports is not surprising. However, Germany's low consumption rates also lead to low imports. The consumption rate in Germany is 54% of GDP, compared with 69% in the United States and 65% in Great Britain (The Economist 2017). This is in part due to high savings, but it is also due to low wage growth and the tax structure in Germany.

German wage growth has been historically low. Following reunification in 1990, Germany became uncompetitive. Some even referred to the state as the "sick man of Europe" (Kluth 2017). In early 2005, German Chancellor Gerhard Schroder (SPD) pushed a massive reform program called Agenda 2010 through parliament. Agenda 2010 rolled back the German welfare state by cutting unemployment benefits, relaxing regulatory practices, and forging an agreement whereby the unions agreed to hold down wages and the government assured job security for workers (Rattner 2015). These reforms cost Schroder and the SPD the chancellorship, but they created a large low wage sector and improved the competitiveness of Germany. According to a December 2010 international labor organization report, real earnings in the country dropped by 4.5 percent over the past decade (Rattner 2015). With low wage growth and a high mentality to save, Germans spend little money on imports. However, Wolfgang

Schäuble, the Finance Minister, tells critics of the current account surplus that wages are on the rise. A minimum wage was introduced in 2015, and in 2016, wages increased by 2.3 percent (The Economist 2017).

Germany also has very high taxes compared to other countries. The OECD reported in April that Germany has the second highest tax rate after Belgium when comparing 35 developed countries around the world. Germany's tax wedge, or the gap between what employees take home in pay and what it costs to employ them, for single, childless workers was 49.4 percent (The Local, "German Has Second," 2017). This means that approximately half of a person's income goes towards taxes and social security contributions in Germany. The OECD average for singles was 36 percent, and in the United States the tax wedge was only 31.7 percent. These high taxes depress Germans' consumption, as they have a lower amount of their income available to spend.

POLITICAL IMPACT OF THE CURRENT ACCOUNT SURPLUS

Relations with the United States

Germany has been an ally of the United States for many years. While the Treasury Department under Obama reported Germany as a country of concern for large trade surpluses, the German-American relationship under the Obama presidency remained strong. Wade Jacoby, a senior fellow at the Transatlantic Academy and a professor at Brigham Young University, says that under the Obama administration "U.S. grouching about German economic policy took on the character of ritualized nagging in which Washington continued to make the case for a change in German policy but where that case was not allowed to intrude into a very productive relationship in other areas... [including] financial regulation, dealing with climate change, and building a

sanctions regime against Russia” (Jacoby, “Surplus Germany,” 2017). Despite this “nagging,” the productive relationship led Germany to remain one of the United States’ closest and strongest allies. This is further evidenced by Obama’s reference to Angela Merkel as his “closest international partner these last eight years” (Deutsche Welle, “Merkel Receives,” 2017).

However, German-American relations have become strained following the election of Donald Trump. On the campaign trail, Trump mostly singled out China and Mexico for their surpluses with the United States, bashing Merkel mostly for her “insane” refugee policy (CBS News 2015). However, since the inauguration, Trump has targeted Germany for its large exports. In a January 2017 interview, Trump suggested Germany could face 35 percent tariffs on products built in Mexico and imported to the United States (Taylor and Rinke 2017). A few weeks later, Trump advisor Peter Navarro, director of the White House National Trade Council, dealt a major blow when he stated that Germany is using a “grossly undervalued euro” to exploit the US and its EU partners. Trump, during his joint press conference with Angela Merkel in March, declared, “I would say that the negotiators for Germany have done a far better job than the negotiators for the United States. But hopefully we can even it out. We don’t want victory, we want fairness,” (Franke and Leonard 2017) and in May, he tweeted, “We have a MASSIVE trade deficit with Germany, plus they pay FAR LESS than they should on NATO & military. Very bad for U.S. This will change” (Jacoby, “President Trump,” 2017). These statements have contributed to the already tense relationship between Trump and Merkel and have led many to question the future relationship of Germany and the United States. German Foreign Minister Sigmar Gabriel said that while he's "optimistic" about working with President Trump, "admittedly, many things are irritating us." (Long 2017).

The German government's frustration with Trump is not surprising. Both a tariff on car imports in general or on car imports from Mexico would hit the German car industry particularly hard, as many German manufacturers produce in Mexico and deliver cars to the United States. Another potential issue could be corporate tax reform. Some Republicans have proposed a cash flow tax with border adjustment, where import expenses cannot be deducted and export revenues are tax-free. This would be the equivalent of an import tariff and an export subsidy, and Germany would likely press the European Commission to bring a case to the WTO to protect its own industry (Möller et al. 2017). These tariffs are not yet in place – but the U.S. is already imposing penalties, such as against Salzgitter, the second-largest German steel producer. Since March 30th, they have been obliged to pay a 22.9 percent punitive tariff for alleged dumping (Franke and Leonard 2017). As Germans fear Trump's protectionist policies, their confidence in the U.S. President to do the "right thing regarding world affairs" has dropped from 86% under the Obama administration to a mere 11% under the Trump administration according to a Pew Research study (Wike et al. 2017).

Relations with the European Union

Germany has been criticized throughout the EU for a variety of reasons, one being its large current account balance. One of the most powerful leaders to speak out against German economic policies is France's new Prime Minister, Emmanuel Macron. Macron says, "Germany benefits from the imbalances within the Eurozone and achieves very high trade surpluses. Those aren't a good thing for Germany or for the economy of the Eurozone. There should be a rebalancing" (Parfitt 2017). Italian Prime Minister Matteo Renzi has also criticized Germany's current account balance, telling reporters: "I think that Germany's balance sheet is problematic,

starting from a trade surplus, which does not respect our rules, and I hope, think and expect that our German friends can finally proceed with rebalancing this" (Deutsche Welle, "Italian PM," 2016).

However, state governments are not alone in their criticisms of Germany. In the most recent Alert Mechanism Report, an annual European Commission report to assess economic imbalances in the European Union, the European Commission labeled Germany a country of economic imbalances for exceeding the current account balance threshold of +6% of GDP (The European Commission, *Macroeconomic imbalance*, 2017). As a result, Germany has been subjected to an in-depth review, specific monitoring under the MIP (macroeconomic imbalance procedure), and a council recommendation. In this recommendation, the European Commission recommended that Germany use fiscal policy to support domestic demand, accelerate public investment at all levels of government, further improve the investment-friendliness of the tax system, reduce the high tax wedge for low-wage earners, and create conditions to promote higher real wage growth to decrease the persistently high current account surplus (The European Commission, *Recommendation*, 2017). The European Commission writes, "The need for action to reduce the risk of adverse effects on the German economy and, given its size and cross-border relevance, on the economic and monetary union, is particularly important" (The European Commission, *Recommendation*, 2017). If Germany does not adhere to these recommendations, they could face sanctions and fines for violation of EU law.

Relations with International Organizations

The International Monetary Fund, or IMF, has also been a large critic of Germany. A recent IMF reported called on Germany to raise public and private investment, encourage

employers to raise wages, and cut income taxes to lessen the burden on its citizens (International Monetary Fund 2017). They have also suggested that Berlin could spend more on areas such as education and research. The IMF warned that change “would remain slow without policy action” and said that these reforms “would accelerate the necessary external rebalancing process” (International Monetary Fund 2017). IMF First Deputy Managing Director David Lipton has asked the German government to make a commitment to reducing the surplus and set a fixed target that could not be exceeded in the future (Jung, Reiermann, and Schmitz 2013). The IMF believes this target should be no higher than 5.5 percent. Of course, the IMF’s desire to see Germany boost its domestic demand is not only about improving Germany. These investments would enhance the country’s growth potential and likely benefit its weaker Eurozone neighbors. “A sustained rise in wage and price inflation in Germany is needed to help lift inflation in the euro area and facilitate the normalization of monetary policy,” according to the IMF (International Monetary Fund 2017).

The Organisation for Economic Co-operation and Development, or OECD, has also recommended reforms to strengthen domestic demand in Germany, such as stimulating investment and reducing barriers to entry in its services sector. Additionally, the OECD recommends implementing policies to reduce the savings rate, such as removing barriers for full-time employment of women, and reforming pensions to lengthen working lives. The OECD says these reforms would have “positive spillovers in the context of subdued economic growth in the euro area” and support adjustment in deficit countries (OECD 2016).

Political environment within Germany

Angela Merkel, labeled as the “leader of the free world,” was recently reelected for her fourth term as Chancellor in September. The main challenger was Martin Schulz, the Social Democratic Party (SPD) candidate. As major trading partners such as the U.S. and E.U. have called for the reduction of the German current account surplus, the two offered varying responses during the campaign. Merkel and the Christian Democrats (CDU) continued to reject criticism of the German current account and plan to keep macroeconomic policy largely unchanged. Merkel said the large surplus is “linked to the quality of our products” and “to the policies of the European Central Bank which we can’t influence” (Parfitt 2017). On the other hand, Schulz and the Social Democrats wanted to increase public investment spending, which would have brought the current account surplus down. Schulz argued that Germany should not decrease its exports, but rather increase public investment in infrastructure such as “high-speed internet connections, transport links, renewable energy, and education, especially in the country’s economically weakest regions” (The Local, “Merkel Challenger,” 2017). He believed this would help Germany because “the German economy will only flourish in the long term in a functioning European economic area” (Delcker 2017). The SPD refused to form a coalition with the Christian Democrats, so now Merkel is working to broker a coalition between the conservatives (CDU/CSU), the Free Democrats (FDP), and the Greens. There will likely be no major changes in macroeconomic policy if this coalition is formed as expected.

SOCIAL AND ECONOMIC IMPACT OF THE CURRENT ACCOUNT SURPLUS: IS THE SURPLUS A PROBLEM? IF SO, WHAT REFORMS SHOULD BE IMPLEMENTED TO REDUCE IT?

This section will explore American, European, and German perspectives of the German current account surplus. It discusses prominent economists and popular news sources' viewpoints from each region, in order to differentiate expert opinions from opinions conveyed to the general public. Each section establishes if there is agreement with regards to the question, "Is the surplus harmful?," and then discusses reforms proposed to reduce it.

American Perspectives

While American economists have criticized Trump's remarks about German trade, the majority agree that the German current account surplus is harmful. Paul Krugman, a Nobel Laureate in economics, says that he suspects part of the US-Germany bilateral imbalance is an "optical illusion, brought on by transshipment" (Krugman, "On The US-Germany," 2017). "Transshipment" is when U.S. exports arrive in other E.U. states and are subsequently shipped to Germany, thus being recorded as exports to that E.U. state rather than to Germany. However, Krugman says the surplus is an issue for the Eurozone. Germany needed to spend more as its neighbors were forced to spend less, but Germany hasn't. Krugman says, "Germany's failure to adjust magnified the cost of austerity" (Krugman, "Those Depressing," 2013). Ben Bernanke, the Former Chairman of the Federal Reserve, also criticizes the German current account surplus in his article, "Germany's trade surplus is a problem". Bernanke says, "the fact that Germany is selling so much more than it is buying redirects demand from its neighbors (as well as from other countries around the world), reducing output and employment outside Germany at a time at

which monetary policy in many countries is reaching its limits” (Bernanke 2016). Bernanke recommends three reforms to decrease the surplus: improving transportation infrastructure, raising wages, and increasing domestic spending via targeted reforms such as increasing tax incentives for private domestic investment, removing barriers to new housing construction, reforming the retail and services sectors, and reviewing financial regulations that may bias German banks to invest abroad rather than at home. These suggestions are echoed in a recent Federal Reserve study that used an estimated Dynamic Stochastic General Equilibrium (DSGE) model with three countries, Germany, the Rest of the Euro Area (REA) and the Rest of the World (ROW) to evaluate the current account surplus. The Federal Reserve calculates that raising German wages would be most effective in reducing the surplus, but boosting German government consumption and government investment would also lead to modest reductions in the current account (Kollman et al. 2014).

While American economists are united in their opinions, American news sources are split. Some agree that Germany’s surplus is problematic. Chris Bryant of *Bloomberg* says, “Germany’s excessive savings could contribute to rising indebtedness and financial instability in countries with large current account deficits,” urging Germany to lift public and private investment (Bryant 2017). Adam Davidson of *The New Yorker* suggests infrastructure investment or a fiscal union within the Eurozone to reduce the surplus, writing, “If Germany doesn’t take steps to reduce its trade surplus [...] there could be the discovery of a bubble in Germany or somewhere else in the Eurozone, a sudden market panic, and a collapse of confidence, leading to stock-market collapse and recession. It could rend the Eurozone apart” (Davidson 2017). Greg Ip of the *Wall Street Journal* blames Germany for the economic downturn in Europe, saying, “The burden has fallen on Germany’s neighbors, including France,

to compete by grinding down domestic wages and prices through high unemployment and fiscal austerity” (Ip 2017). He, like the others, suggests higher wages and government investment to reduce domestic saving and increase consumption. However, some journalists disagree, arguing that the surplus is not a problem. Raoul Ruparel of *Forbes* argues that Germany does not harm deficit countries in Europe, because none of the peripheral Eurozone countries have the capacity or networks to match or compete with Germany in its key export sectors. He also argues that many of Germany’s imports from Eurozone countries are linked to its exports, so reducing one may in turn reduce the other (Ruparel 2015). Others argue that the German surplus actually helps America. Jennifer Rubin of the *Washington Post* says, “Germany is about the worst target one can pick for trade demonization,” quoting Dan Mitchell of the libertarian Cato Institute when he said, “even if American consumers only purchased cars built in Germany, that wouldn’t be a bad thing since that money inevitably comes back to the U.S. economy, either to purchase American-produced goods and services or to invest in America” (Rubin 2017). Frances Burwell, a distinguished fellow at the Atlantic Council writes for *the Hill* that Germany supports American investment and employment, noting that companies such as Siemens, T-Mobile, BASF, Daimler and Aldi have a large retail presence and employ almost 700,000 American workers (Burwell 2017). Alan Blinder and Richard Fausset of the *New York Times* also report on the jobs that German companies provide, specifically in South Carolina. They note that German investment has resulted in more than 10,000 new jobs in South Carolina over the past five years, and quote the mayor of Greer, SC when he said, “There was a real sense of urgency that we need to be clear to BMW... that we can’t take [Trump’s] rhetoric lightly. For us, this isn’t a political issue. This is a matter of livelihoods and of a regional economy” (Blinder and Fausset 2017).

European Perspectives

European economists generally believe the German surplus is a problem. In a recent survey of 67 European economists conducted by two European think tanks, 69 percent agreed that German current account surpluses are a threat to the Eurozone economy; 67 percent agreed that the German government should increase public spending to reduce the surplus (Den Haan et al. 2016). Increasing government investment is the most popular proposal. Several economists at The Center for Economic and Policy Research, or CEPR, suggest that Germany invest specifically in its digital infrastructure, as it is estimated that the country has realized only 10% of its digital potential; its physical infrastructure, as commuters suffer from more than 300,000 km of traffic jams caused by infrastructure gaps every year; and its energy infrastructure, as a survey suggests many German executives would support higher investment in green energy even if it meant higher taxes (Mattern and Mischke 2017). However, Europeans have many suggestions beyond government spending. Francesco Giavazzi from Universita Bocconi and Nicholas Oulton from the London School of Economics advocate tax cuts, and Wendy Carlin from the University College of London proposes increasing incentives for women to participate in the labor force (Den Haan et al. 2016). Emiliano Rancaccio from Universita degli studi del Sannio suggests creating a European wage standard, in which surplus countries (like Germany) would be required to accelerate the growth of nominal wages with respect to labor productivity (Brancaccio 2012). Daniel Gros and Thomas Mayer from the Centre for European Policy Studies suggest the creation of a sovereign wealth fund for Germany to invest excess savings globally and help crisis countries close their deficits (Gros and Mayer 2012). Several economists at CEPR suggest a scaling down of public provisioning of banking services, a reduction in unemployment benefits towards the OECD average, and a reduction and simplification in business taxes. They

say that these measures could reduce the surplus by about 1.25 percent of GDP (Bornhorst and Ivanova 2011).

However, not all European economists think the German surplus is a problem. Robert Kollman from the Universite Libre de Bruxelles says the surplus is not a threat to the Eurozone because Germany trades more with the rest of the world than with the rest of the Eurozone, while Pietro Reichlin from Universita LUISS G. Carli notes that German exports to the rest of the world contain intermediate inputs from E.U. peripheral economies, so their surplus benefits these economies. Francesco Lippi from Universita di Sassari argues: “I do not see why the savings of my neighbour should be a problem for me. Rather they are a potential source of financing my investment. I do not know a single reasonable model where current account surpluses are a problem” (Den Haan et al. 2016). Nezh Guner from the Universitat Autònoma de Barcelona agrees the surplus is simply structural, saying that it reflects positive supply shocks, such as labor market reforms, and the current demographic structure (Den Haan et al. 2016).

European news sources reflect similarly; the majority see the surplus as harmful, but there are a few exceptions. Ben Chu of *the Independent* says Germany’s “chronic underconsumption and large surpluses deserve to be buried, not praised” (Chu 2017). He says that the imbalances lead to excess debt in deficit countries, raising the risk of a financial crisis if foreigners attempt to deleverage all at once or if they lose the confidence of overseas creditors. *The Economist* calls Germany “an awkward defender of free trade,” saying that the savings glut in countries like Germany made the adjustment for peripheral countries needlessly painful (The Economist 2017). *The Economist* argues that the government should use its budget surplus to invest in roads and schools, advance digitalization as the country is ranked 25th in the world in average download speeds, and increase after-school care to allow mothers to work full-time.

Barry Eichengreen of the *Guardian* suggests cutting taxes, and investing in infrastructure, health and education to reduce the surplus, noting that there are zero German universities in the top 50 globally (Eichengreen 2017).

However, several writers at the *Financial Times* disagree. Martin Sandbu of the *Financial Times* argues that the surplus is not harmful to the Eurozone because only about one-fifth of Germany's current account surplus is with the rest of the Eurozone, and the bulk of that is with France (Sandbu 2017). Gillian Tett of the *Financial Times* rejects criticisms of low wages in Germany, saying that Germany is hardly a low-cost base with an average industrial wage of 38 euros per worker, compared with 26 euros in the US, and says it is "ridiculous to suggest that Germany has implemented a deliberate policy to weaken the euro for mercantilist reasons" (Tett 2017). Wolfgang Münchau agrees that the surplus is harmful to the Eurozone, but says that the proposals to reduce the surplus have no chance. A lower current account surplus requires that Angela Merkel lose and that her party is not even part of the next government, which is very unlikely. He says, "Calling for more investment in the current political environment is about as realistic as asking the tooth fairy to take the surplus coins from Germany to redistribute to everybody who needs them elsewhere in the Eurozone" (Münchau 2017).

German Perspectives

The German government has consistently refuted criticism of the current account surplus. Sigmar Gabriel, Germany's Foreign Minister, says that if the United States wants Germany to export fewer goods, it could just "make better cars" (Cermak 2017). Jens Weidmann, head of the Bundesbank, said he didn't "see any reason why Italy should co-finance bridges in Germany or why Portugal should fund sections of the German motorway or vice-versa" (Vinocur 2017).

However, Wolfgang Schäuble, the Finance Minister, has a more calculated response. Schäuble admits that at just over 8 percent of GDP, the current account surplus is too high (Reiermann and Sauga 2017). He notes that the Germans have taken a number of measures to further strengthen domestic demand, such as improving the framework conditions for private investments, increasing government investments, and introducing a legal minimum wage (Handelsblatt Global Staff, “Schäuble Sees End,” 2017). Tax cuts worth 11 billion euros have been introduced, and in the medium term, aging society will contribute to a reduction in the surplus (Böcking and Reiermann 2017). However, Schäuble says that “it is intellectually weak to claim the government can make any fundamental changes that would work against the current-account surplus” (Schäuble 2017). The government has no influence over private employees’ salaries, and “excessive wage increases could cost jobs, weakening domestic demand” (Hildebrand and Greive 2017). Furthermore, several billion euros set aside for infrastructure investment weren’t called upon by various municipalities because they cannot keep up with construction (Hildebrand and Greive 2017). According to the European Commission, even if there were more capacity for construction, if the government increased investment by 30 billion euros (31.9 billion USD), it would only reduce the current account surplus by 0.2 percentage points (Schäuble 2017). Another option would be to lower taxes further, but wiggle room here is limited by a “debt brake” that requires the government to maintain a balanced budget. Even if he exhausted the 2016 budget surplus and used up the excess 12 billion euros in debt leverage, he could only bring taxes down by 18 billion euros, which is a small sum in comparison to a current account surplus of 270 billion euros (Hildebrand and Greive 2017). Schäuble argues that increases in government spending in Germany cannot solve structural problems in other countries. To critics, he says:

“Instead of talking about weakening the strong, we should really be asking ourselves how to strengthen those countries that are not yet strong enough” (Schäuble 2017).

Schäuble’s argument reflects the ideology of many Germans. This includes many prominent business leaders, news publications, and economists. Citigroup Chief Economist Willem Buiter said he does not support the demand that Germany go into debt to increase demand in neighboring countries, with the comment: “Nobody does that” (Cermak and Wiebe 2015). Ingo Kramer, the Head of the Confederation of German Employers’ Associations, and Eric Schweitzer, the President of the association of German Chambers of commerce and Industry, argued that the current account surplus was simply a sign of the competitiveness of the local economy and the high quality of German-manufactured goods (Handelsblatt Staff, “Surplus of Envy,” 2017).

German newspapers have also refuted criticism of the surplus. Andreas Kluth, Editor-in-Chief of *Handelsblatt Global*, argues in his publication, “Let’s not infantilize Germany’s trade surplus,” that the high savings rate is a voluntary and rational decision by free individuals, and Germany’s investment rate is on par with the average in Europe. He notes that Germans would prefer to spend wisely not just more, and he says that erasing a trade deficit equal to 8 percent of GDP with public spending is not credible when Germany’s public investment is only a bit above 2 percent of GDP (Kluth 2017). *Spiegel* staff also refute criticism of the surplus in the article, “Complaints about German exports unfounded.” They argue that deficit countries can benefit when German exports soar because their products can be found as inputs in almost every product with the “Made in Germany” label (Jung, Reiermann, and Schmitz 2013). They also argue that businesses in the export sector create growth and jobs

in other countries, such as Volkswagen, the largest foreign investor in Portugal, and BMW, which employs about 7,000 employees at its plant in Spartanburg, South Carolina alone.

Lastly, several German economists have echoed Schäuble's argument. Holger Görg, a professor at the Kiel Institute for the World Economy (IFW), argues that punishing Germany for its surplus "would be absurd" because no one can be forbidden from buying German goods. The real issue, he says, is why countries like Spain or Italy haven't managed to become more competitive (Jung, Reiermann, and Schmitz 2013). This viewpoint is also expressed by Stormy-Annika Mildner from the German Institute for International and Security Affairs who says that German dependence on exports is "only one piece of the puzzle," because there are structural problems in other countries, such as limited labor market flexibility in Mediterranean countries and a lack of a fiscal union in the Eurozone (Alessi 2013). Clemens Fuest, one of the prominent German economists and the President of the Ifo Institute for Economic Research, says that politics may force Berlin to address its surplus, but pure economics dictate that Germany ignore criticism (Fuest 2017). Total domestic investment has been consistent at about 20 percent of GDP in Germany, whether the surplus has been 2.4 percent or 7.3 percent of GDP (Fuest 2017). The surplus has surged due to prudence, and Germany needs to save in preparation for a possible fiscal crisis as its population ages and workforce shrinks. A lower surplus would actually drive up interest rates, which would be bad for highly-indebted countries, and a reduction in its current account surplus, even by as much as 2.5 percentage points from the current level of 8.5 percent of GDP, would boost global demand by just 0.1 percent (Fuest 2017). He says, "The world would lose a scapegoat for its economic difficulties. Little else

would change” (Fuest 2017). Between the government, business leaders, newspapers, and economists, there is a strong argument against criticism of the current account surplus.

However, there are also many German news sources and economists that agree with critics of the surplus. Christopher Cermak and Martin Greive, two editors at *Handelsblatt Global*, argue that Germany needs to be more constructive on trade. Cermak believes the best option is to raise public investment and encourage private investment. He argues that with interest rates near zero, Germany should upgrade its roads, bridges and broadband lines. To get firms to invest more at home, Germany should liberalize its service sector and other parts of the economy. Cermak notes that “Starting a new business is notoriously difficult in Germany: The country ranks 117th on the World Bank’s Doing Business report” (Cermak and Wiebe 2015). On the other hand, Greive focuses mostly on private investment; he concedes that Germany cannot bring down its surplus with a couple of billion euros in extra government funding, but says that “if German investors prefer to put their money overseas and often invest in financial bubbles over there, politics has failed to make the country attractive enough for private investment” (Greive 2017). Greive argues that the federal government should reduce the surplus through tax cuts to improve investment conditions and ease regulations in the service sector.

Several leading German economists support these editors’ views. Hans-Werner Sinn, the former head of the Ifo Institute for Economic Research, says, “The surpluses are not in Germany’s best interest since we keep getting more and more IOUs, which we will never be able to cash in.” Half of Germany’s net external assets – the amount of money its trading partners owe it for goods received – is made up of credits. Sinn says: “Many of the automobiles and machine tools that we export have been simply given away” (Handelsblatt Staff, “Surplus of Envy,” 2017). Carl Christian von Weizsäcker, an economist with the Max Planck Institute for

Research on Collective Goods, says Germany should strengthen its imports while keeping its exports strong by creating a braking mechanism for the current accounts balance. Parliament would sink the value-added (sales and services) tax, fueling consumers in Germany to spend more, buying import goods and thus aiding the economies of the countries delivering the goods and services (Hawranek et al. 2017). Perhaps the most prominent economist to agree with critics is Marcel Fratzscher, the President of DIW Berlin, an economic research institute, and the former Head of International Policy Analysis at the European Central Bank. Fratzscher says, “European neighbors would benefit from stronger investment in Germany. Germany, however, would profit first and foremost, as the investment gap and the resulting excessive trade surpluses are detrimental to the domestic economy” (Handelsblatt Global Staff, “German Exports,” 2017). Fratzscher argues that the trade surplus has little to do with the euro or the competitiveness of Germany’s exports, stating that the real problem is low levels of imports due to the investment gap (Fratzscher, “Curse of the Trade,” 2017). He says the gap is the result of policy failures and protectionist policies in the non-tradable services sector. Fratzscher argues that Germany should liberalize the country’s services and remove other barriers to investment. He believes Germany should “improve its digital and transportation infrastructure; strengthen market mechanisms to encourage more renewable-energy development; address its shortage of skilled labor; change its tax system to strengthen incentives to invest; and reform its regulations to reduce uncertainty” (Fratzscher, “Germany’s Misunderstood,” 2017). These proposals are unlikely to be realized, however, given the current German political environment.

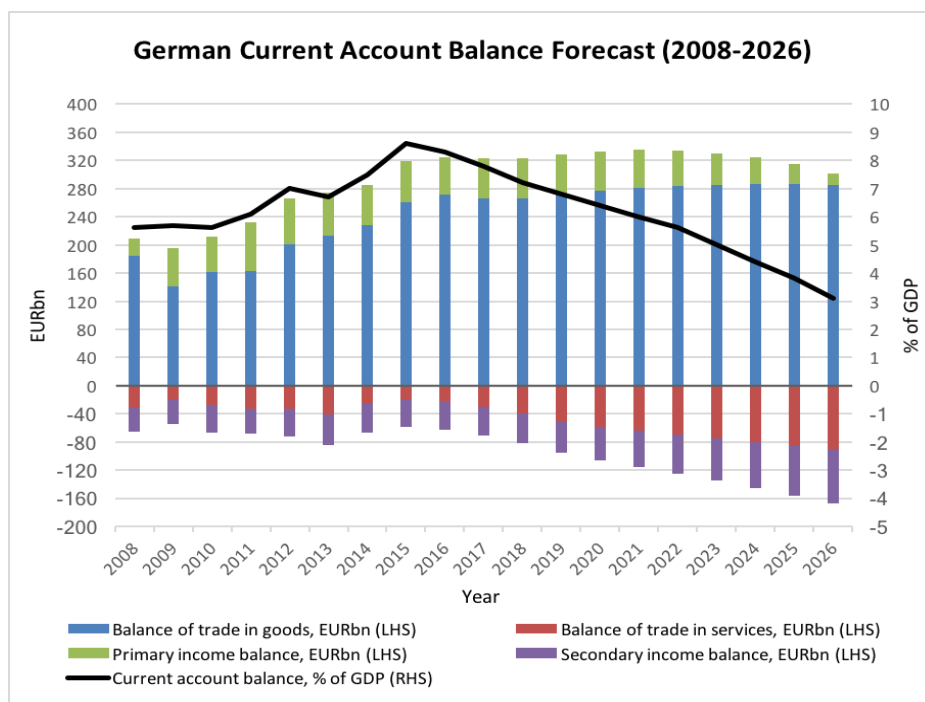
Insights

Collectively, we can see that most American and European economists believe the German current account surplus is harmful to the global economy. While most European news sources also saw the surplus as harmful, American news sources were split. Overwhelmingly, the Germans believe that it is not harmful to the global economy; this opinion is expressed by the government, business leaders, news sources, and economists. However, a few prominent news sources and economists such as Handelsblatt Global and Marcel Fratzscher have raised the surplus as a point of concern. The most widely proposed reforms are increased infrastructure investment, increased public spending, increased wages, reforming the services sector, and reducing business taxes. None of these reforms are highly likely to be implemented due to the government's opinion that the surplus is not harmful, and due to Germany's balanced budget.

THE FUTURE OF TRADE POLICIES AND GERMANY

Forecast of the German current account balance

While the current account balance has been rising since the early 2000s, experts say that it has peaked at 8.5% of GDP in 2015. In the next ten years, the German current account balance is expected to fall to nearly 3% of GDP. This is largely accounted for by a predicted wage raise, increased investment, and larger consumption from the aging population.



Source: BMI Research and Eurostat data

The future of German policies

If Martin Schulz, the SPD candidate, won, Germany could have seen an effort to overhaul macroeconomic policies. Schulz promised to increase investment in public infrastructure, a maneuver that would have decreased the current account surplus. Schulz also wanted to focus on overall E.U. financial stability, and said he was considering using Germany's "current account surplus and fiscal maneuverability to stimulate underperforming European

economies” (Henri-Flamand 2017). This would have brought the current account surplus down at a faster rate, appeasing its neighbors and allies.

However, since Angela Merkel and the CDU won the election, we can conjure that there will not be any major changes to policy in the short run. The current account surplus will still be attributed to Germany’s competitiveness, and arguments that it is a structural problem will be refuted. If wages rise, investment increases, and consumption rates rise at their predicted rates, the current surplus will likely fall slowly but steadily for the next ten years. Germany will continue to receive pressure from other E.U. member states and perhaps the United States for the next few years; however, worries will likely subside once the German current account surplus falls below six percent of GDP, the E.U. mandated limit.

If these macroeconomic changes do not occur, the current account surplus will remain high. This would certainly be problematic for Germany politically, and perhaps economically. The Trump Administration would likely continue to pressure Germany to decrease their high surpluses, as the United States aims to decrease its trade deficit. Debt-ridden, struggling E.U. member states will become increasingly frustrated, as will the European Commission and the International Monetary Fund. The *Financial Times* says this scenario could even “propel the continent towards a two-tier Eurozone, as Germany and other strong northern European nations begin to cut ties to peripheral southern European countries” (Henri-Flamand 2017). These large macroeconomic imbalances within the E.U. could eventually lead to a financial crisis within the European Union, which may hit Germany particularly hard as it relies so heavily on exports.

The future of American policies towards Germany

Recently, Trump administration attacks on Germany have faded. Merkel and Trump were cordial with one another at the G20 Summit in Hamburg, and the Treasury Department's semiannual report to Congress had a somewhat softer tone than that of last fall (Jacoby, "Surplus Germany," 2017). In terms of foreign policy, the Trump Administration seems to prioritize national security and immigration over trade, focusing on escalations with North Korea and building a wall on the Mexican border. With regards to trade specifically, Trump appears to have placed renegotiating the North American Free Trade Agreement (NAFTA) as the lead item on the agenda. Therefore, Germany could avoid confrontation over its trade surplus, especially if it continues to decline as current forecasts project. If American sentiment is any indication of the future of German-American trade relations, 79% of Americans said that increased trade with Germany would be somewhat good or very good, whereas only 14% said it would be somewhat bad or very bad according to a recent Pew Research Center survey (Pew Research Center and the Bertelsmann Foundation 2014). It appears that Germany may avoid a trade war, for now.

However, Germany should not simply brush this issue under the rug. Senate Democrats unveiled seven trade tenets as part of their new economic agenda, and these proposals appear to take the same "America First" stance as the Trump administration. The new Democratic proposals include the creation of an Independent Trade Prosecutor, an "American Jobs Council" with authority to block foreign investments if they could cost jobs, stricter "Buy America" rules for federal contractors, requirements that U.S. companies complete federal infrastructure projects, cracking down on currency manipulation, changing the tax code to punish companies that engage in outsourcing, and an American Jobs Security Council that could veto foreign company purchases that fall through (Seitz-Wald 2017). Senate Democratic Leader Chuck

Schumer (N.Y.) also railed against China, arguing that trade policies must be put in place to stop Chinese companies from taking over American industries (Needham 2017). The Democrats' proposals have little-to-no prospect in a Republican-controlled Congress, but could have a significant impact on German car and manufacturing companies if they are passed. Furthermore, while Schumer focuses on the Chinese now, Germany could easily be the next country on the chopping block. Germany should heed caution as American trade policies continue to evolve in the upcoming months.

If the Trump Administration takes action and implements the tariffs they have threatened, it is likely that Germany will respond. They could incrementally increase duties on American imports, allow German companies to write off the U.S. import tax on their German tax declarations to compensate them for their competitive disadvantage, or lower corporate taxes and the amount of social contributions employers must pay in Germany to make Germany more attractive to international corporations (Hoffmann et al. 2017). Of course, this could cost tax payers in Germany billions of euros. Brigitte Zypries, the Minister for Economics and Energy, suggested that Germany could make deals with individual U.S. states, stating that "The governor of South Carolina, for example, has no interest in seeing BMW cut jobs there" (Handelsblatt Staff, "Surplus of Envy," 2017). It is unclear how escalated the situation could become if Germany and the United States were to engage in a trade war.

The future of E.U. policies toward Germany

E.U. policies towards Germany are unlikely to change significantly. While Germany will continue to clash with the European Commission and the IMF until its surplus declines, ultimately there will not be many consequences beyond the scoldings and consultations. Germany is the strongest economy in the European Union, and it is especially vital to the success of the E.U. following Brexit. Therefore, Germany can get away with apologizing for the surplus without taking any real action.

Emmanuel Macron, another large critic of the current account surplus, is also unlikely to have any real effect on policies towards Germany. France's economy has been struggling, and the country has failed to remain in compliance with the E.U.'s deficit rules. Until his country complies with these guidelines, it is unlikely that his calls for Germany to meet the E.U.'s surplus rules will be taken seriously.

One event that could impact E.U. policies towards Germany is the expiration of ECB President Mario Draghi's term in 2019. Draghi has been extremely critical of Germany, stating that Germany redirects demand from southern European countries, making it more difficult for these struggling economies to recover. Draghi has sought to stimulate these struggling economies through low interest rates and a massive bond-buying program, policies the German government frequently criticizes. However, it has been reported that the German government wants Jens Weidmann, the head of the Bundesbank, to succeed Draghi when his term expires. "An ECB led by Mr. Weidmann would give greater weight to Germany's more hawkish views," *Handelsblatt Global* notes (Handelsblatt Staff, "Merkel's ECB," 2017). If Weidmann were to become the ECB President, Germany would likely clash less with the ECB on monetary policy.

CONCLUSION

The German current account balance is highly controversial. While some Americans, Europeans, and Germans believe that it is not a threat to the global economy, many are concerned that it worsens conditions for struggling peripheral European economies. European leaders, international organizations, and President Trump have all spoken out against the German trade surplus. Germany has refuted criticisms thus far – and is likely to continue this approach in the short run due to Angela Merkel’s recent reelection. The German current account surplus is already predicted to fall as a result of a predicted wage raise, increased investment, and larger consumption from the aging population. Economically, Germany has no real incentive to reduce its surplus, but politically may need to make reductions to appease its European counterparts and the United States. Ultimately, only time will tell how trade policies may change and affect Germany in the long run -- international politics and the global economy are a deeply intertwined and complex web.

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