

# SWP Comment

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## Stubbornly Germany First

Options for Reducing the World's Largest Current Account Surplus

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Germany continues to be a major exporter of both goods and capital. In 2018, the current account surplus – at about \$340 billion – will continue to be the world's largest. Whilst German policy-makers and society celebrate the surpluses as the result of the competitiveness of German companies, they persistently ignore the other side of the balance of payments. Germany finances consumption and investment – abroad. The repeated explanations of the German government – arguing that the surpluses reflect private decisions that cannot be influenced by government policy – are not convincing. The German government has many options to reduce or raise taxes and can shape incentives to save or invest, but prefers to ignore these opportunities. Whilst many German observers eagerly point to the self-interested economic policies of the United States, Germany itself continues to place its own interests above the legitimate concerns of both its European and Atlantic partners. A continuation of the “Germany First” economic policies of the past two decades would constitute both a burden for European integration and the global trading system.

Germany's persistently high current account surpluses are sources of concern in Europe and America. To date, the German Federal Government has neither succeeded in successfully initiating measures to reduce surpluses nor has it been able to explain convincingly why the surpluses should be unproblematic. The impact of German foreign trade policy on other economies within and outside the European Union (EU) is considerable. The surpluses of well over 7 per cent of Germany's gross domestic product (GDP) contribute to rising debt levels in other economies, which in turn is regularly labelled by German politicians as being the results of irresponsible policies. But Germa-

ny's policies themselves are equally irresponsible, because the country's high capital exports are only made possible by capital imports from other nations. The failure to address the high current account surpluses weakens Germany's position as an advocate of a liberal world economic order.

The German surplus since 2000 has contributed to widespread disapproval of a further deepening of the international division of labour. One effect is trouble in the European integration process; a second is the continuing reluctance to advance the liberal trade regime. In Europe, the partner countries rightly point to the costs they have to bear in order to facilitate positive



economic development in Germany: Financing their import surpluses requires them to borrow. Vulnerabilities are thus emerging: With interest rates likely to rise again in the future, the indebted economies run the risk of a financial crisis. Economic history clearly shows that capital-importing countries are highly likely to be confronted eventually with a decline in capital flows, and consequently with liquidity bottlenecks.

### **Both Lenders and Borrowers Matter**

Surplus countries, on the other hand, do not encounter any barriers in today's international economic order. As long as there are countries that are prepared to import capital, surplus countries can export capital, and thus build up claims abroad. Today's world economic order would demand a special degree of responsibility from countries with current account surpluses. The reason is the asymmetric consequences for deficit countries. The global economy operates like a system of communicating tubes, and the current accounts of all national economies balance each other out. Since current account deficits put economies in a dangerous debt situation, surplus countries should reduce their capital exports. This requires political action, as there are no automatic mechanisms to help reduce current account surpluses.

German politicians and society lack the insight that their own capital exports can be problematic for other countries. The robust rhetoric of the American president may be inappropriate in tone, but it has a true core: Germany ignores the consequences of its foreign economic policy for other economies, and thus inspires protectionist reflexes. Germany's foreign economic policy is double-edged: It emphasises the benefits of exports but fails to address the disadvantages of a model that sells goods to foreign countries while liberally handing out supplier credits.

Germany's policy destabilises international economic relations. To a degree,

it is thus comparable to that of the United States (US) at the end of the 1920s and early 1930s: Then, as now, there is an inexperienced economic power that is driving the debtor countries deeper into debt while developing a sense of moral superiority. This perception became clearly visible during the European debt crisis starting in 2010, when numerous observers in Germany accused the crisis states of irresponsible behaviour. In 2010, for example, Chancellor Angela Merkel noted that any Swabian housewife would have cautioned against taking on extensive debt. Other German politicians supported this criticism. Foreign media, such as *The Economist* and *The Guardian*, explained that, in Germany, "guilt" (*Schuld*) and "debt" (*Schulden*) are closely linked linguistically – but also in a normative way, as both "debt" and "debtors" are often denounced in the public discourse. However, the enthusiasm at home and abroad for the model of low debt recommended by German politicians ignores the fact that the Swabian housewife is running a household, not a national economy: She can ignore the macroeconomic effects. Conversely, politicians ought to be wiser: An economy characterised by virtuous austerity would suffer from weak overall economic demand.

As a country with persistent current account surpluses, Germany has every reason to rethink its own economic model as well. From an economic point of view, deliveries abroad were often given away for free because receivables had to be written off. The losses for the German economy amounted to between just under €300 billion and €730 billion, depending on the assessment method. Exported capital often had to be written off – for example in the case of investments in US real estate bonds. Although the current German economic policy favours the stakeholders directly benefiting from exports – such as shareholders of German automobile companies and the employees – it also imposes high financial burdens on many German citizens. Therefore, it is wrong to assume that the effects of the economic boom since 2005 – only

briefly interrupted by the global financial crisis in 2008 – are beneficial to the entire German society: A distinct group benefits much more than others.

## Why Are Current Account Surpluses an International Policy Issue?

Since the turn of the millennium, Germany has been generating steadily increasing surpluses in its current account. The OECD expects a new record surplus of \$340 billion in 2018. Neither the German media nor the German government are very concerned about this. Rather, the high surpluses continue to be interpreted primarily as an expression of the performance of German companies. Criticism from abroad – whether from the EU Commission, the International Monetary Fund (IMF), or the American government – has been, and continues to be, rejected as inappropriate.

The continuing rejection of criticism from abroad permanently weakens Germany's reputation as a responsible player in international affairs that takes into account the interests of other states. For decades, German policy-makers have tried to be perceived as acting unselfishly, both in relation to other European countries and in relation to the US. The ongoing reproof of foreign critics, as either being ignorant of the economic context or unable to understand the benefits of Germany's surpluses, does not fit in with the model of a policy that propagates international cooperation. Moreover, the focus of many German observers on the current account – one side of the balance of payments – is wrong because it ignores the capital account, the other side of the balance of payments. By definition, current account surpluses are accompanied by capital exports. The Bank for International Settlements has labelled capital exports as "vendor financing".

In 2017, the IMF pointed out that, in the 1920s, a comparable problem was observed. The US and France, which were generating current account surpluses at the time, were

not prepared to reduce them. This made it difficult for capital-importing countries such as Germany and Great Britain to cope with their high debt levels and paved the way for the Great Depression of the 1930s. The lack of flexibility in exchange rates – the gold standard applied – and demand-dampening policies in the creditor states show parallels to the current situation.

An economy that produces current account surpluses builds up receivables vis-à-vis foreign countries. Net exports of goods and net capital exports are one and the same. In other words, Germany uses a significant part of its unconsumed economic income to build up claims on foreign countries instead of investing it domestically. Since Germany has been doing this for many years, the number of claims on foreign countries has risen sharply. However, creditors such as Germany can also lose capital: If debtors cannot, or do not want to, service the liabilities, the creditor must waive claims and make write-downs. In recent years, Germany has had this unpleasant experience and lost several hundred billion euros.

From 2004 up to, and including, 2018, Germany's accumulated current account surpluses amounted to \$3,508.6 billion. There is no sign of a significant decrease in surpluses. As a share of GDP, the current account surplus reached its highest level of 9.0 per cent in 2015. For 2018, the OECD expects a surplus of 8.3 per cent of GDP and only a small decline to 7.9 per cent of GDP in 2019. The current account surpluses are matched by exports of domestic savings. The high level of savings in Germany has become a problem because capital has not been invested in Germany but rather abroad – and investments have not always been sound.

## The Perspectives of Foreign Observers

Abroad, Germany has been receiving heavy criticism for several years. Christine Lagarde, then French Finance Minister and now IMF Managing Director, had already

found clear words for Germany's surpluses in 2010. She considered these to be a burden for other eurozone members and pointed out that it is not enough to insist on compliance with deficit rules. Lagarde's blunt warning breached a taboo in Franco-German relations.

Simon Tilford, a British economist, criticises the fact that the Federal Government and the media in Germany repeatedly announce imminent reductions in current account surpluses, which then never come to pass. He speaks of "waiting for Godot". It would, Tilford argues, be beneficial for all concerned parties if the surpluses were gradually eliminated. British journalist Martin Wolf has been criticising Germany for years. He renewed his criticisms of Germany's current account surpluses in 2016, rightly asking of what productive use German capital is for other countries if it cannot be used in Germany itself. German savings are exported and not invested in roads, schools, or factories. Furthermore, it remains unclear to him why structural reforms in other economies should lead to an investment boom that has yet to take place in Germany.

In 2017, the EU Commission repeated its diplomatic criticism of Germany. In particular, reference was made to the impact of surpluses on other countries. A reduction in the surplus would favour the prospects for a rebalancing in the rest of the euro area and the EU. The Commission's view is shared by the IMF, which regularly analyses the effects of cross-border flows in its "External Sectors Reports". The IMF describes surpluses of more than 4 per cent of GDP as being "substantially stronger than [is] justified by fundamental data". The IMF blames the very strict fiscal policies in some countries, including Germany and the Netherlands, for the high surpluses. The US also continues to complain about Germany's surpluses and criticises Germany for not taking advantage of its fiscal leeway: If the German government were to collect fewer taxes and invest more, for instance in digital infrastructure, less capital would be exported.

*The Economist* dedicated a cover story to Germany's current account surpluses in July 2017. The title of the article was "Vorsprung durch Angst" (Advantage through Fear). The magazine noted that Germany is hopelessly linked to a model that considers exports to be more important than all other economic policy goals. Some foreign observers very clearly point out the role of German policy in creating the framework conditions for the high surpluses. During the reign of Chancellor Gerhard Schröder, Germany had carried out a "fiscal devaluation". Social security contributions were reduced for employers, while value-added tax (VAT) was increased. Social security contributions are paid by exporters but not by importers. The exact opposite is true of VAT: This does not have to be paid by exporters. Those observers interpret the restructuring of Agenda 2010 as a conscious economic policy leading to a strengthening of the export economy and the activation of import-competing companies. Of course, this policy could be corrected if Germany so wished: A reduction in VAT, coupled with an increase in employers' social security contributions, would strengthen the purchasing power of the population and dampen the competitiveness of businesses.

## **The Position of German Observers and the Federal Government**

In Germany, the debate about the benefits of current account surpluses, "*Leistungsbilanzüberschüsse*", is probably already suffering from the fact that the term "*Leistung*" (performance) appears in it and has a positive connotation. "*Leistung*" is considered desirable. Many observers apparently have the impression that an economy with a high current account surplus "achieves" more than economies with current account deficits. Seemingly, many observers misinterpret the downsides of high capital exports. In Germany, a marked pride in the high surpluses and status as the "export world champion" has developed – without regard for the economic effects. The English

term “current account” could also be used in German, but few observers make reference to the “Bilanz der laufenden Posten”. If this term was used instead of “Leistungsbilanz”, it would be clear that it is a part of the national accounts and not an indicator of the strength or weakness of an economy.

It is remarkable that, although there has been a lot of discussion in Germany in recent years about the supposed leadership responsibility that Germany should assume in Europe, possibly even globally, little time has been devoted to examining the conditions for a leading role. Occasionally, one might receive the impression that other countries only have to follow the German example in order to be successful. Slowly, very slowly, it seeps through that the string of pearls of international crises may also have something to do with Germany’s pursuit of its national economic interest. Whilst nobody uses the term “Germany First”, the reality is that the country has put its economic interests above those of its partners.

The reaction of the Federal Ministry of Finance to criticism from abroad in 2013 reflected the ruling opinion in Germany: These surpluses are, according to the Ministry, no cause for concern — neither for Germany nor the eurozone or the entire global economy. In addition, the Ministry argued that there had been a reduction in current account balances *within* the eurozone.

In 2017, the German government continued to insist on a perspective that ignores the capital account. It pointed out that the current account surpluses are the results of supply and demand decisions by companies and consumers on the world market. In a joint position paper published in May 2017, the Ministry of Finance and the Ministry of Economics tried to invalidate the critics’ arguments. The title is already revealing: It talks about German-American *trade* relations. Capital movements do not appear in the heading. The tone of the text is apologetic. Overall, German politics is helpless because the current account surplus is caused by private actors.

Is it appropriate to regard the consequences of private decisions as unchange-

able and irrelevant to economic policy? In recent years, the Federal Government has taken responsibility for erroneous decisions by private actors in the event of financial crises. With regards to Greece, the consequences of the decisions of private creditors were not ignored, and crisis management was not left to the London Club, which would have been the appropriate institution for restructuring privately held debt of a public borrower. Instead, the German government, the EU Commission, the IMF, and other member states of the eurozone developed a plan to rescue creditors. The policy was not determined by *laissez-faire*, *laissez-passer*, but by the need for comprehensive and ongoing crisis management. Such behaviour is inconsistent: Either politicians ignore the incorrect decisions made by private actors when exporting capital or they deal with it. Then, however, they should not intervene asymmetrically only when crises arise, but take measures to reduce risks beforehand.

The German government likes to point out to critics that it is not in a position to influence the level of surpluses. This is simply incorrect because the state has a direct influence on current account and capital account balances. A government surplus increases capital exports; a government deficit lowers it. The Federal Government, through its policy of balanced budgets, therefore actively refrains from making a contribution to reducing the current account surpluses. Other countries must therefore live beyond their means and borrow so that Germany can export excess savings. The perfidious twist is that the German government then criticises these economies for living beyond their means.

### Losses to Date As a Result of Capital Exports

However, it is not only the negative consequences for capital importers that should be taken into account when evaluating German capital exports. The cumulative current account surpluses would have to be

identical to claims on foreign countries. In the past, Germany has been forced to make massive write-downs on assets abroad.

The ambiguity of Germany's foreign economic policy is very clear: On the one hand, export performance and the export of goods create jobs and growth in Germany, and on the other hand, the frequent write-downs on foreign investments prevent citizens from benefiting adequately from the successes. The delivery of goods – such as cars to the US – often took place without consideration of the financing side. From a macroeconomic perspective, the cars were given away.

The IMF has clearly identified this problem of capital-exporting economies. Surplus countries often have to accept partial losses of their savings. In addition, the high savings levels of surplus countries lead to the increased availability of capital, which has a dampening effect on interest rates. According to this view, it is German savers who are themselves responsible for the low interest rates on their savings.

So why does Germany stick to a model that has serious disadvantages? What happens to the high volume of claims on foreign countries? Net current account surpluses would have to be reflected through an increase in so-called net foreign assets. This is the sum of foreign receivables, less the receivables of foreigners.

According to OECD figures, the cumulative current account surpluses from 2000 to 2016 amounted to just under \$2,900 billion. At an exchange rate of \$1.18 to the euro, this corresponds to about €2,460 billion. However, German foreign assets amounted to only €1,727 billion at the end of 2016; €733 billion had to be written off. This represents a loss of 29.8 per cent, or 23.4 per cent of the annual economic output of €3,134 billion (2016). Converted to the number of inhabitants, this results in an arithmetical loss per German citizen of a remarkable €8,863. Consequently, Germany's investors have not achieved any increase in the value of their foreign investments, but have instead lost a lot of money abroad.

The assessment that Germany has to provide for demographic change and that exporting savings is therefore a wise strategy omits a central fact: The countries that import German capital are also struggling with ageing populations. However, Germany's trading partners are building up liabilities. Even at second glance it is not clear why it should be possible for other ageing societies to pay back capital to Germany. Future German pensioners should not count on American, British, or Italian pensioners lowering their standards of living in order to service the loans previously taken out.

### **Some Options for Economic and Fiscal Policy to Reduce Surpluses**

Is doing nothing a sensible policy? Whilst of course possible, such a policy entails considerable risks for the stability of the integration process in Europe and today's liberal world trade order. It seems conceivable that trading partners will take defensive measures against German surpluses. The new Italian government is clearly on a collision course currently with other European countries. Whilst the rhetoric of some Italian policy-makers is blunt, their motivation is obvious: Italy is mired in lasting economic stagnation. Germany enjoys record levels of employment, but policy-makers see no need for reducing the exportation of capital and unemployment. That narrow interpretation of international economic relations is a burden for Europe. A responsible player would consider the effects of its performance on other countries. Germany is weakening the European integration process with its high surpluses.

Germany has four main options for reducing Germany's current account surpluses, and thus the export of capital: The country could export less or import more. Just as effective would be a reduction in domestic savings. However, the optimal way to reduce the current account surpluses is to increase domestic investment.

### **Increase in government investment**

A factor over which the state has direct influence is state investment. An increase in government investment would have a comparatively rapid impact on the development of the current account. However, there is a problem: How can these additional funds be spent sensibly? There are certainly many examples of overdue improvements – for example to the infrastructure. However, the objection that today's significantly streamlined public administrations would no longer be in a position to control additional annual public investments of €30 billion cannot be prematurely dismissed.

### **Increase in domestic demand due to significant real-wage increases**

In particular, the strengthening of domestic demand is repeatedly recommended as a panacea. According to the theory, a noticeable increase in wages paid in Germany would not only strengthen import demand, but also dampen the competitiveness of German companies, and thus facilitate an upswing in other European countries. But here the critics of Germany are mistaken. If wage increases do not flow into the consumption of foreign goods but lead to an increase in domestic savings, higher wages would lead to a further expansion of capital exports.

However, it is true that wage levels in Germany did not fully reflect Germany's economic performance in the past. Compared to suppliers from other European countries, German producers are too cheap. This problem could be solved both by raising wages and increasing profits. There is no doubt that the German trade unions are in a comparatively weak position: They know that higher wages are possible and financially viable, but at the same time the options of the companies ought to be taken into account. Trade unions that rely on drastic increases in wages are thus spurring investment abroad and fuelling reductions in domestic investment.

### **Temporary reduction in VAT**

The economist Carl Christian von Weizsäcker has proposed a significant reduction in VAT, from 19 to 14 per cent, in order to reduce the current account surpluses. Firstly, von Weizsäcker justifies this with Germany's interest in a continuing integration process in Europe. Secondly, he sees only two ways out of the current situation in Europe: either a transfer union, which redistributes in favour of the poorer economies of the eurozone, or the introduction of a current account restriction.

A reduction in VAT would particularly support recipients of small incomes. Consumption would become cheaper. The reduction would send a clear signal to Germany's partner countries. Certainly it is not possible to reduce VAT without violating other fiscal objectives. A significant decline in government revenues would result in new government deficits and violate the goal of reducing public debt. However, in consideration of the importance of the goals, temporary new government debt is the lesser evil compared to stagnation in European integration or the strengthening of mercantilist policies in non-European partner countries of Germany.

### **Reduction in private savings by abandoning the retirement age limit**

In Germany, people have to retire at a set age. There is limited flexibility, but that requires the consent of the employer. Workers should be given the right to continue working beyond the normal age limit by unilateral declaration. That measure would remove the pressure to save a certain amount for retirement. As a positive side effect, the labour force potential could be increased. In its latest consultations with the German government, the IMF has illustrated the positive effects of raising the retirement age.

### **Higher taxes on corporate profits**

German companies make major contributions to the current account surpluses. The financial balance of companies has changed drastically in recent years. In 2000, com-

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panies in Germany were still borrowers and net debtors. Change has been taking place since 2009, and companies in Germany have been net creditors since 2016. In 2000, the net borrowing of private companies was considerable: at minus 4.8 per cent of GDP. In 2016, private firms were net savers and generated savings of 2.9 per cent of GDP. The financial position of the private sector was effectively reversed and the balance rose by 7.7 per cent of GDP. The IMF's chief economist underlined that the high savings levels of companies are important sources of German capital exports. But are taxes on corporate profits really low in Germany?

The OECD has examined both the share of taxes on corporate profits in total tax revenues and the corresponding share of GDP. In both categories, Germany is – from the point of view of companies – a tax haven. The OECD study does not analyse nominal tax rates, but actual taxes levied. In Germany, the share of taxes on corporate profits fell from 6.12 per cent to 4.72 per cent of total tax revenues between 2006 and 2015. In the US, for example, the figure was 8.33 per cent in 2015, and the OECD average was 8.86 per cent. The share of taxes on corporate profits was lower only in France (4.64 per cent), Hungary (4.71 per cent), and Slovenia (4.03 per cent).

Furthermore, the picture does not change when considering taxes on corporate profits as a proportion of GDP. Once again, the figure in Germany fell from 2.11 per cent of GDP in 2006 to 1.74 per cent in 2015. In 2015, only three OECD countries had lower taxes on corporate profits (Latvia, Slovenia, Turkey). The OECD average was 2.8 per cent.

## Conclusion

Germany has become a burden for its partner countries and is causing imbalances in international economic relations. The country sees itself as a model student. Many

Germans believe that the robust economic growth and the high degree of integration into the global economy are proof of the superior organisation of the German economy. Very few people think about the effects of the German surpluses on other European economies and the US. Hardly anybody considers the contribution of Germany to vulnerabilities in other economies due to its high levels of capital exports. At the same time, however, other countries are accused of behaving irresponsibly because they incur debt with Germany. Bluntly stated: Germany preaches moderate borrowing, but its capital exports fuel credit booms elsewhere.

Germany's current account surpluses are not only due to the better economic performance of German companies, but also to political measures. Corporate taxes are very low compared to other OECD countries, which allows companies to accumulate large sums of cash, which are then transferred abroad and invested there. The state no longer relies on savings in the country, but it has been in the black for several years. The tax system favours exporting companies and places a comparatively heavy burden on employees outside exporting companies.

The most important point is simple: The Federal Government ought to identify the reduction in capital exports as a political task. At stake are not only Germany's reputation as a responsible and constructive player in international relations, but not least the future of the European integration process and the further development of globalisation. As an important power in Europe and the global economy, Germany ought to consider the consequences of its actions for other countries. To stabilise the European integration process and prevent the further discrediting of globalisation, Germany must change its foreign economic policy and swiftly reduce the high surpluses.

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