

The Rift Over Germany's Trade Surplus

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Eurocrisis in the
Press

By [Henrik Müller](#)

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At first it was just the US administration that [criticised](#) Germany harshly for running high external surpluses. Now even the European Commission is starting an investigation in the context of the eurozone's imbalances procedure, as Commissioner Olli Rehn [said](#) at a press conference in Brussels on November 13.

This is new. Germany has been running high current account surpluses for years, but until now relatively little pressure has been put on the federal government to take action. The new rhetoric suggests that patience may be running out. Even EU sanctions against Germany are conceivable.



Interestingly, public opinion in Germany reacted virtually in unison (a rare event given the country's heterogeneous media system). The prevailing view was that the accusations were ill-advised, dead-wrong and driven by envy of Germany's overwhelming competitiveness rather than by proper economic assessment. The government, business representatives, economists and media representatives were quick to reject the US interpretation, namely that the "anemic pace of domestic demand growth" was causing "a deflationary bias for the euro area, as well as for the world economy". Germany was put "in the pillory", the news magazine *Der Spiegel* [wrote](#), in line with the often-heard argument that the country was a scapegoat as other nations suffer from past economic mistakes.

"The Germans are outraged", Nobel prize-winning economist Paul Krugman [commented](#) in *The New York Times*, finding the Berlin government's arguments "just bizarre". The *Financial Times*' Martin Wolf [thought](#) Germany needed a lecture in economics (which he was happy to provide).

Such sharply contrasting views are not confined to the question of current account surpluses, but can also be found regarding other economic issues. The highly critical reaction to the ECB's interest rate cut on November 7 in the German media is another case in point. While the divergence in public sentiment may be understandable given the centripetal economic forces at play within the Euro area, it is still troubling. With Germans feeling more and more comfortable in playing the outsider's role, political consensus in Europe may be ever harder to reach, perpetuating the economic crisis.

What is going on here? Why do Germans collectively feel rebuked when it comes to external surpluses? The answer, from my point of view, has three dimensions: history, economy and policy.

Start with history. Running external surpluses is a matter of German national pride, more than it is in other countries. Ever since the late 19th century, when the label "made in Germany" became a symbol of the catch-up of the "Deutsche Reich", Germans have considered themselves an industrial nation whose international competitiveness serves as a gauge of collective self-esteem, as I have [argued](#) elsewhere. So criticising external surpluses means criticising a foundation of the nation.

Turning to the economy, (West) Germany has been a surplus country for most of the time since World War II, though surpluses from the 50s to the 80s were not as high as they have been since the latest German economic revival after 2005, peaking at 8 per cent of GDP in 2007. Even after the Great Recession of 2009, current account surpluses remained between 6 to 7 percent. These figures clearly are too high. The huge surplus may be Germany's next top problem – because, in the first place, it makes the German economy vulnerable to external

shocks. It is far from obvious, though, that it is a problem for the rest of the euro area or even for the world economy as a whole.

A closer look at the trade figures reveals that German industry is running big surpluses vis-à-vis emerging market countries, and not anymore vis-à-vis the rest of the euro area. Within the currency union a rebalancing can be observed, albeit at a painfully slow pace. These trends lead to the question whether it hurts Spain, say, if Germany is running a substantial surplus vis-à-vis China or Indonesia? Probably not. All this shows: assessing balance of payments positions of an open economy that's part of a currency union may result in ambiguous conclusions.

So what about policy? What are the instruments at hand? If Germany still had an individual currency, the answer would be straightforward: let the exchange rate appreciate. That's what China was told and has done in recent years. In the context of the eurozone, though, a stronger currency would do harm to struggling economies such as Italy or Spain. Therefore, a *real* appreciation is needed, i. e. wages and prices in Germany have to rise faster than in the rest of the eurozone. This type of market-based rebalancing is underway, but it may take too long to be politically acceptable in countries suffering from very high unemployment, such as Greece, Portugal or Spain.

If wages are to rise faster, how could this be achieved? After all, in Germany wages are set in a decentralised fashion. They are an outcome of labour market developments. This is not a command and control economy. Furthermore, large numbers of immigrant workers – net immigration, mainly from Southern and Eastern Europe, is now close to 400 000 people per year – contribute to on-going wage moderation.

In theory, expansionary fiscal policy could be an option. Indeed, the on-going coalition talks in Berlin suggest that the next “Grand coalition” government is on a spending spree. But with government debt high – the debt-to-GDP ratio is still above 80 per cent – the room for manoeuvre is limited. More fundamentally, it is questionable whether it would help Europe's weaker economies, if Germany (the last large euro country with a triple-A rating) lost its status as a prime borrower. Who would provide credible backing for the ESM, the eurozone's rescue fund, then?

There is one obvious policy instrument by which the current account surplus could be cut: transfers. If other tools are not at hand, transfers from Germany (and other prospering eurozone regions) to struggling regions will have to play a part in rebalancing the currency area. Tellingly, virtually all the other currency areas on the globe have such transfer systems. To introduce a pan-Euroland unemployment insurance, for instance, as France's president Francois Hollande has suggested, would be a good idea. But given the self-complacent mood in the German public, and especially in the media, such an approach does not look too likely.

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Note: This article gives the views of the author, and not the position of the Euro Crisis in the Press blog, nor of the London School of Economics.