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Thinking ahead for Europe

Germany as Scapegoat

Daniel Gros

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Could Germany, which accounts for 1% of the world's population and less than 5% of its GDP, actually be responsible for the sorry state of the global economy? The US Treasury Department started the chorus at the end of October with a report on currency manipulators, which criticised Germany's current-account surplus. Then the European Commission added its voice last month, when it published its scorecard on macroeconomic imbalances and called for an in-depth analysis of the German surplus.

The emphasis on Germany seems much more justified within the context of Europe. But, even there, Germany represents less than 30% of the eurozone's GDP (and less than one-quarter of output in the EU as a whole). Germany is important, but not dominant.

This focus on Germany also overlooks the fact that the country represents just the tip of a Teutonic iceberg: *All* northern European countries with a Germanic language are running a current-account surplus. Indeed, the Netherlands, Switzerland, Sweden, and Norway are all running surpluses that are larger as a proportion of GDP than Germany's (see figure below).

These small countries' combined annual external surplus is more than $250 billion, slightly more than that of Germany alone. Moreover, their surpluses have been more persistent than those of Germany, which ten years ago had a current-account deficit, whereas its linguistic kin were already running surpluses of a similar size as today. Over the last decade, this group of small countries has recorded a cumulative surplus larger than even that of China.

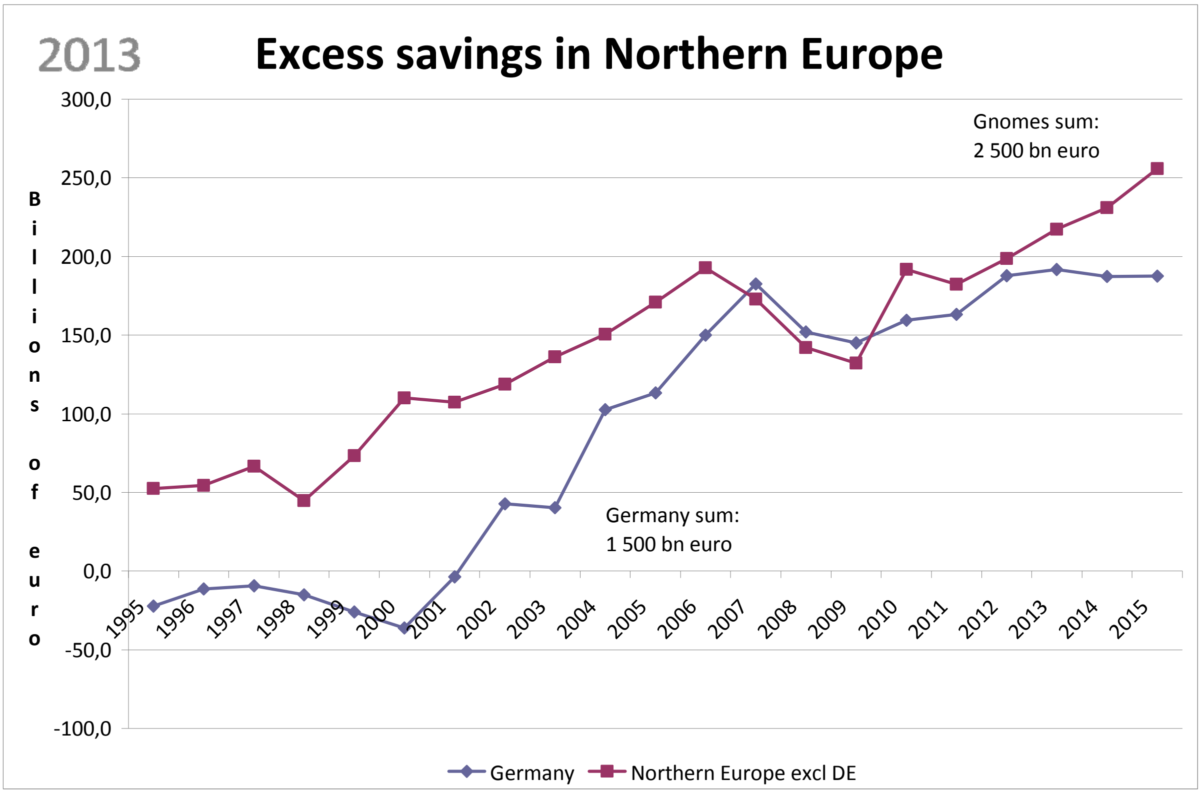
Are all of these countries guilty of mercantilist policies? Have all of them engaged in competitive wage restraint?

Much of the facile policy advice proffered to correct the German surplus seems misguided when one examines the persistent surpluses of this diverse group of countries. Some are also in the eurozone (the Netherlands), others have pegged their currency to the euro unilaterally (Switzerland), and still others maintain a floating exchange rate (Sweden).

Within the eurozone, the counterpart to the German surpluses used to be the deficits of the peripheral countries (mostly Spain, but also Portugal and Greece). This is no longer the case.

Today, the counterpart to Germanic excess saving is 'Anglo-Saxon' dissaving: All English-language countries are running current-account deficits (and have been doing so for some time). Taking the United States, the United Kingdom and major Commonwealth countries together, the sum of the Anglophone current-account deficits amounts to more than $800 billion, or roughly 60% of the global total of all external deficits.

Daniel Gros is Director of the Centre for European Policy Studies. A shorter version of this column was originally published by Project Syndicate on 6 December 2013 and disseminated to newspapers and journals worldwide. It is republished here with the kind permission of Project Syndicate.



It is not surprising that national policy-makers (and media) in Anglo-Saxon countries are complaining of the German surplus. But action by Germany alone will have little impact on these countries' fortunes, because their deficits are much larger.

The key question one should ask is: Who would benefit if Germany started to import more? The peripheral eurozone countries account for only about 10% of German imports, compared to almost 40% for the other surplus countries in northern Europe. Stronger domestic demand in Germany would thus benefit these other surplus countries (with low unemployment) four times more than the peripheral countries, where unemployment is so much higher. Other countries with a structural surplus, including Russia, China and Japan, would also benefit more from higher German imports than would Spain or Greece.

The discussion of Germany's surplus thus confuses the issues in two ways.

First, though the German economy and its surplus loom large in the context of Europe, an adjustment by Germany alone would benefit the eurozone periphery rather little. Second, in the global context, adjustment by Germany alone would benefit many countries a little, but other surplus countries would benefit disproportionally. Adjustment by all of northern Europe would have double the impact of any expansion of demand by Germany alone, owing to the high degree of integration among the "Teutonic" countries.

This applies to both the European and global contexts. Coordination within the eurozone (for example, through the excessive imbalance procedure, which might now be applied to Germany), seems largely insufficient if the aim is to help the peripheral countries. At the global level, the Anglophone deficit countries, too, would benefit much more if all of northern Europe increased its domestic demand.

Germany has been an attractive target for external-deficit countries in Europe and beyond. But beating up on Germany alone appears to be the wrong way to get results.