The German problem

Why Germany’s current-account surplus is bad for the world economy

The country saves too much and spends too little

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THE battle-lines are drawn. When the world’s big trading nations convene this week at a G20 summit in Hamburg, the stage is set for a clash between a protectionist America and a free-trading Germany.

President Donald Trump has already pulled out of one trade pact, the Trans-Pacific Partnership, and demanded the renegotiation of another, the North American Free-Trade Agreement. He is weighing whether to impose tariffs on steel imports into America, a move that would almost certainly provoke retaliation. The threat of a trade war has hung over the Trump presidency since January. In contrast, Angela Merkel, Germany’s chancellor and the summit’s host, will bang the drum for free trade. In a thinly veiled attack on Mr Trump, she delivered a speech on June 29th condemning the forces of protectionism and isolationism. An imminent free-trade deal between Japan and the European Union will add substance to her rhetoric (see article).

There is no question who has the better of this argument. Mr Trump’s doctrine that trade must be balanced to be fair is economically illiterate. His belief that tariffs will level the playing field is naive and dangerous: they would shrink prosperity for all. But in one respect, at least, Mr Trump has grasped an inconvenient truth. He has admonished Germany for its trade surplus, which stood at almost $300bn last year, the world’s largest (China’s hoard was a mere $200bn). His threatened solution—to put a stop to sales of German cars—may be self-defeating, but the fact is that Germany saves too much and spends too little. And the size and persistence of Germany’s savings hoard makes it an awkward defender of free trade.

Imperfect harmony

At bottom, a trade surplus is an excess of national saving over domestic investment. In Germany's case, this is not the result of a mercantilist government policy, as some foreigners complain. Nor, as German officials often insist, does it reflect the urgent need for an ageing society to save more. The rate of household saving has been stable, if high, for years; the increase in national saving has come from firms and the government.

Underlying Germany's surplus is a decades-old accord between business and unions in favour of wage restraint to keep export industries competitive (see article). Such moderation served Germany's export-led economy well through its postwar recovery and beyond. It is an instinct that helps explain Germany's transformation since the late 1990s from Europe's sick man to today's muscle-bound champion.

There is much to envy in Germany's model. Harmony between firms and workers has been one of the main reasons for the economy's outperformance. Firms could invest free from the worry that unions would hold them to ransom. The state played its part by sponsoring a system of vocational training that is rightly admired. In America the prospects for men without college degrees have worsened along with a decline in manufacturing jobs—a cause of the economic nationalism espoused by Mr Trump. Germany has not entirely escaped this, but it has held on to more of the sorts of blue-collar jobs that America grieves for. This is one reason why the populist AfD party remains on the fringes of German politics.

But the adverse side-effects of the model are increasingly evident. It has left the German economy and global trade perilously unbalanced. Pay restraint means less domestic spending and fewer imports. Consumer spending has dropped to just 54% of GDP, compared with 69% in America and 65% in Britain. Exporters do not invest their windfall profits at home. And Germany is not alone; Sweden, Switzerland, Denmark and the Netherlands have been piling up big surpluses, too.

For a large economy at full employment to run a current-account surplus in excess of 8% of GDP puts unreasonable strain on the global trading system. To offset such surpluses and sustain enough aggregate demand to keep people in work, the rest of the world must borrow and spend with equal abandon. In some countries, notably Italy, Greece and Spain, persistent deficits eventually led to crises. Their subsequent shift towards surplus came at a heavy cost. The enduring savings glut in northern Europe has made the adjustment needlessly painful. In the high-inflation 1970s and 1980s Germany's penchant for high saving was a stabilising force. Now it is a drag on global growth and a target for protectionists such as Mr Trump.

The shift from thrift

Can the problem be fixed? Perhaps Germany's bumper trade surplus will be eroded as China's was, by a surge in wages. Unemployment is below 4% and the working-age population will shrink, despite strong immigration. After decades of decline, the cost of housing is rising, meaning that pay does not stretch as far as it used to. The institutions behind wage restraint are losing influence. The euro may surge. Yet the German instinct for caution is deeply rooted. Pay rose by just 2.3% last year, more slowly than in the previous two years. Left to adjust, the surplus might take many years to fall to a sensible level.

The government should help by spending more. Germany’s structural budget balance has gone from a deficit of over 3% of GDP in 2010 to a small surplus. Officials call this prudence but, given high private-sector savings, it is hard to defend. Germany has plenty of worthwhile projects to spend money on. Its school buildings and roads are crumbling, because of the squeeze on public investment required to meet its own misguided fiscal rules. The economy lags behind in its readiness for digitalisation, ranking 25th in the world in average download speeds. Greater provision of after-school care by the state would let more mothers work full-time, in an economy where women’s participation is low. Some say such expansion is impossible, because of full employment. Yet in a market economy, there is a tried and trusted way to bid for scarce resources: pay more.

Above all, it is long past time for Germany to recognise that its excessive saving is a weakness. Mrs Merkel is absolutely right to proclaim the message of free trade. But she and her compatriots need to understand that Germany’s surpluses are themselves a threat to free trade’s legitimacy.

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