



The political economy of the German current account surplus

Andreas Busch¹

Abstract: This chapter discusses a long-standing feature of Germany's political economy, namely its persistent current account surplus. While it has been criticized by many of the country's trading partners as a cause of economic difficulties (most recently in Southern Europe during the Eurozone crisis), within Germany is mostly perceived as a success story and proof of the country's economic competence and competitiveness. The article discusses the historic development of the current account (which also saw lasting deficits after unification), before turning to theoretical attempts to explain the development of the 'trading state'. The chapter then discusses the domestic and international debates around the surplus, emphasizing the political nature of that debate, before moving on to discuss whether (and if so how) the German government can influence the current account development in the future. The conclusion argues that the current account surplus can be regarded as the exercise of a relative institutional advantage – namely Germany's coordinated wage bargaining system, which is highly successful in stabilizing unit labour costs. Being rooted in a consensus between employers and trade unions to exchange non-maximisation of wage proceeds for a guarantee of safe employment, a high degree of persistence can be expected even in the case of politically negative consequences.

1 The debate about the German current account surplus

The German economy underwent a severe crisis around the turn of the century, when it was characterized as the “sick man of Europe”. Emerging from that crisis after a period of soul-searching and reforms, it has been going from strength to strength economically for most of the last decade or so. Unemployment has declined, employment risen and growth has been steady (even in the aftermath of the financial markets crisis of 2008ff.). In its most recent economic survey of Germany, the OECD has summarized the situation as one where “economic and social wellbeing are strong”, with “record-low unemployment, employment growth and real wage gains” (OECD 2018, 15).

But this success has brought forward from the country's partners new criticisms about the accompanying persistent trade surpluses that the country has been running. This surplus has been linked to problems surrounding the sovereign debt crisis in the Euro system, more broadly to the economic crises in many other European countries and also to the recent electoral successes of neo-protectionist positions on both sides of the Atlantic. During a visit to the

¹ Georg-August-Universität Göttingen
andreas.busch@sowi.uni-goettingen.de

European Union in May 2017, US-President Trump complained about Germany's trade surplus. With characteristic bluntness, he told European leaders that Germany was being unfair with its trade arrangements and that "The Germans are bad, very bad".² Commentators more given to detail (such as the *Financial Times*) agree that "Donald Trump is not alone" and that the trade surplus is indeed a cause for concern both "at home and abroad" (Jones 2017). Seasoned academic analysts from economics and political science also ask "What drives the German current account? And how does it affect other EU Member States?" (Kollmann et al. 2015) and speak of a "trading state unleashed" (Armingeon and Baccaro 2015), while some suggest that Germany's current account surplus may actually be a sign of weakness of the domestic economy: "the purchasing power of much of German society is so weak that it's no wonder they rely heavily on external demand." (Jacoby 2017).

This chapter looks at the debate about the current account deficit and inquires about the crisis potential it holds for both Germany and her trading partners. After a look at the characteristics of the German economy, the structural and historical context of the current account surplus will be discussed before we review the theoretical concepts that are on offer for explaining them. A more detailed look at the discussion is then followed by an analysis of the viability of the solutions offered, before the conclusion discusses further suggestions both for the political and the academic sides of the debate.

2 Structural and historical context

To acquaint ourselves with the subject of the economy of the Federal Republic of Germany, let us first turn to its structural characteristics before taking a look at the main challenges that have influenced its development over time.

Structural data of the German economy identify it as one of the most important economies in the world. Measured by GDP, it is the fourth largest (after the US, China, and Japan) and the largest economy in Europe.³ One of its hallmarks is its strength in international trade (i.e. exports of goods and services), of which its global share in 2017 was 7.7 per cent, while its share in GDP was only 3.3 per cent and share in population merely 1.1 per cent.⁴ In 2016, Germany exported goods and services worth 1.207 bn Euro while its imports were valued 955 bn Euro. Germany thus has an export to GDP quota of 38.5 per cent, which in international comparison is very high for a country of its size.⁵ A country's export quota usually varies inversely with the size of its domestic market: thus in 2015, the export quota was 8.3 per cent in the United States, 14.3 per cent in Japan, and 75.9 per cent in the Netherlands. Germany's

² See <https://www.dw.com/en/trump-slams-germanys-us-trade-surplus-as-bad/a-38986975> (20.8.2018).

³ World Economic Outlook Database. International Monetary Fund. 17 April 2018.

⁴ International Monetary Fund 2018, 219.

⁵ Statistisches Bundesamt 2017, chapter 16.

quota, however, clearly exceeds that of France or the United Kingdom (20.9 per cent and 14.9 per cent, respectively) and almost meets that of far smaller Austria (40.5 per cent).⁶

One can therefore say that the German economy is particularly strongly interwoven with the global economy. Its most important trading partners (ranked by export share) are the United States, France, the United Kingdom, the Netherlands and the People's Republic of China. But although this sounds global, the focus of German international trade is clearly on Europe: In 2016, 58.6 per cent of its exports went to the European Union (and 57.9 per cent of its imports came from there), while the numbers for the Eurozone were 36.7 per cent and 37.7 per cent, respectively.⁷

The precise composition of the ranking of import and export varies from year to year. But the international competitiveness of the German economy as well as its continuing rise in export success have been enduring features of the decades since the middle of the 20th century. With exports usually surpassing imports, Germany has often run quite substantial current account surpluses. Over the years the country has thus often managed to use its competence in international trade as a domestic “growth engine” (Loschky and Ritter 2007). However, running current account surpluses over a longer period of time is by no means an unequivocally positive development. There are clear downsides as well, not least because of the increased dependence of the domestic economy on the world economy. In addition, running surpluses means foregoing domestic consumption for accruing foreign assets – which, however, may lose value if their exchange rate depreciates. And on top, there are also negative political consequences: because there can be no surpluses without other countries running current account deficits, the issue is one that from time to time triggers political controversies with the trading partners as well as debates in the domestic policy community (see below).

Still, inside Germany the international trade performance is mainly seen as a success story. It is one of the tenets of West German post war history that both the strong integration into the world economy as well as the permanent current account surpluses have been a source of economic growth, full employment, and rise in living standards since the 1950s (Abelshauser 2011, 259). Between 1950 and 1960, the value of exported goods had risen fivefold, with a further two-and-a-half-fold rise up to 1970 (Deutsche Bundesbank 1988, 254). By the end of the 1980s, the Federal Republic of (West-) Germany's share of world trade had risen to 12 per cent and surpassed even that of the United States of America (Busch and Goldbach 2011, 277). Pre-unification Germany had thus developed from a country destroyed by defeat in World War II to an “*économie dominante*” in Western Europe, and the key to that success story could be found in its strategy of export expansion (Kreile 1977, 776).

Over the past seven decades, the German economy has not been static. It had to cope with a number of different challenges and did so with varying degrees of success. The first decade after 1949 was a period of reconstruction for the Federal Republic in which the “social market

⁶ OECD 2017, 57.

⁷ Statistisches Bundesamt 2017.

economy” established itself as a successful model. The conscious limitation of the role of the state advocated by the *Freiburg School* lay at its root. The original draft of its *magna carta*, the “Gesetz gegen Wettbewerbsbeschränkungen” (law against inhibitions to competition) contradicted deep-seated traditions of cartels being regarded as an element of order in the economy. Getting it onto the statute books took almost a decade, and Ludwig Erhard (even at the height of his reputation) had to fight against opposition from the industry, normally a staunch ally of his own party. Major modifications were the result (and a political defeat for Erhard), but eventually the *Cartel Office* was set up to maintain competition, with a potential veto against firm mergers it deemed anti-competitive being its strongest weapon (Katzenstein 1987, 88). While the influence of European economic integration after 1957 on German competitiveness and export performance was very strong, this was not the result of strategic action by the business community: in fact, it only tentatively supported political initiatives in that direction. Consequently, its influence on the *Treaties of Rome* was (in spite of the existence of an “External Economic Relations Advisory Board” at the economics ministry since 1947) “surprisingly small” (Piel 1975, 213). Competitiveness also benefited from the direct and indirect effects of abundant labour supply: some 10 m came from Eastern territories and the GDR; after the building of the Berlin Wall stopped that inflow, foreign workers (“Gastarbeiter”) were recruited, who by 1971 accounted for 10.3 per cent of the labour force (Kreile 1977, 777). This exerted downward pressure on wages, while inflation awareness legitimised the *Bundesbank’s* restrictive monetary policy. Both factors contributed to an undervaluation of the *Deutschmark* which in turn promoted rising export surpluses, a conscious goal for the central bank from an early stage (Holtfrerich 1998). By 1974, exports constituted 23.1 per cent of GDP (1950: 8.5 per cent, 1960: 15.9 per cent) – roughly one in five jobs depended on it.

The end of the Bretton Woods system led to a substantial revaluation of the *Deutschmark* in the early 1970s, while the oil price shock triggered a rise in both inflation and unemployment. Yet compared to other, similar countries, the Federal Republic weathered that storm quite well regarding its economic outcome profile (Scharpf 1987). Already in years before, the German government had been willing to accommodate US wishes related to the big ally’s balance of payments problems, both for strategic reasons and because the country was interested in the maintenance of an open and liberal world economic system. It was thus also prepared to cooperate in a joint program agreed at the Bonn summit of 1978, to undertake a fiscal stimulus in exchange for an American commitment to fight inflation and the accompanying decline of the US dollar (Putnam and Bayne 1987). German economic policy thinking, these years made clear, differed from that of its partners: Keynesianism had gained little influence in academia and policy making (Allen 1989); instead, a discourse on competitiveness and repeated debates on the competitiveness of “Standort Deutschland” (Germany as a location for business) characterised discussions about economic policy (Dyson 2005). After suffering through the effects of the second oil price shock at the beginning of the 1980s, however, competitiveness improved again if measured against the country’s current account: a brief period of deficits

towards the beginning of the decade turned into substantial surpluses in the second half of the 1980s, peaking with a surplus of 57 bn. DM in 1989. Germany again showed itself to be an “extraordinary trader” (Hager 1980).

German unification, happening as a complete surprise in less than one year and completed by late 1990, changed the situation drastically. The political and economic collapse of the GDR left the Federal Republic with no choice but to pick up the pieces. They manifested themselves as high unemployment, a drastic need for investment in the East of united Germany and hence a requirement for massive internal transfers from West to East Germany. The formerly persistent current account surpluses of West Germany turned into a deficit position for a whole decade (1991 to 2001) in united Germany. Partially, these results were the consequences of political choices made during the unification process, especially the chosen exchange rate between the *Deutschmark* and the *GDR Mark* of 1:1 in the face of drastic productivity differences (the official exchange rate had been 5:1 since January 1990). By choosing this exchange rate, the government opted to increase the consumption power of East German citizens, to send a political signal of East-West equality and to raise the incentives for GDR citizens not to migrate to West Germany. Economically, this choice implied a revaluation of some three hundred per cent, which priced firms in East Germany out of the market, leading to the collapse of many firms. Massive transfers from West to East became necessary as a consequence of rising unemployment, resulting in huge burdens for the government budget and the whole system of social policy (Ritter 2006; Busch and Goldbach 2011).

Apart from these immediate consequences, unification also contributed to a transformation of the established German system of industrial relations (Streeck and Hassel 2003). This, however, did not happen as a conscious policy, but rather as a by-product of the choices made. An expansion of existing employer associations into the East was only possible if membership there was decoupled from adherence to the collective wage agreements. Trade unions had similar problems: eager to integrate trade union members from the East into their organisation, they first achieved an all-time high of 11.8 m members in 1991, only to slowly lose about half their members in the twenty years to follow (Schönhoven 2014). Being less encompassing, a weakened social partnership was of little help in bridging the problem of persistent productivity differences. The consequential ongoing wage differentials between West and East undermined both sides’ ability to stabilise their membership and delegitimised the system of highly-centralised wage negotiations. By the turn of the century, the crisis of the “German model” was widely debated and its viability doubted by some (see Streeck 1997 and Busch 2005 for differing perspectives on this issue).

Only nine years after German unification, the introduction of the *Euro* in 1999 was another sea change in economic context. Germany, with about 60 per cent of its exports going to EU member states, had a huge interest in eliminating exchange rate risk. But the views of its government (intent on signalling an ongoing commitment to European integration after German unification) and the *Bundesbank* (hesitant to give up its independence and its leading role in

European monetary policy) had diverged in the negotiations (Dyson and Featherstone 1999). Agreement was eventually reached, although differences in economic thinking persist between the member states (Brunnermeier et al. 2016). The immediate consequences of the Euro proved ambiguous for the German economy: While the country had largely managed to assert its preferences with regard to the institutional setup, the goals, and the independence of the new *European Central Bank* (ECB), it had also lost its advantage as reputation leader in low inflation. The latter had brought the benefit of the lowest interest rate (measured as 10 year government bond rates), with beneficial consequences for business. In the run-up to the introduction of the Euro, however, interest rates in all future member states had converged towards the German level, providing them with a substantial economic boost, while Germany lost a relative advantage. In addition, Germany's traditionally low inflation now counterintuitively turned into a disadvantage: since the ECB can only set one nominal interest rate for the whole of the Eurozone, and since the real interest is determined by subtracting the inflation rate from the nominal interest rate, Germany ended up with a higher real interest rate than most of its partner countries in the Eurozone (which had higher inflation). This hampered its prospects for economic growth (Busch 2014).

On the other hand, the Euro also had positive effects for the German economy which started to manifest themselves after a couple of years. Now Germany's low inflation rate began to convey its usual comparative advantages again: Other, more quickly growing Eurozone countries had seen wages rise during their economic upswing, to the point where those rises would surpass increases in productivity. This resulted in escalating real unit labour costs and – as a consequence of firms having to raise prices to pay for them – declining competitiveness in the marketplace. In Germany, however, unit labour costs had remained largely stable, resulting in positive effects for the country's international competitiveness (Busch 2014). And since the country's competitors were now locked into the common currency, they no longer had the option to compensate by devaluing their own currency, making the advantage for Germany permanent.

During the “Great Recession” after 2008, Germany's cooperative model of industrial relations displayed its strengths as well. In the face of a drastic decline in orders, not least from export markets, employers and trade unions alike were determined to defend export success, requiring the protection of the highly skilled workforce from unemployment. The existence of working time accounts as well as a subsidy scheme for retaining surplus workers (*Kurzarbeit*) helped achieve those goals; employers refrained from lay-offs, while unions agreed to wage moderation and more flexible working time rules (International Monetary Fund 2010, 71-81; Unger 2010).

Overall, a substantial liberalisation of industrial relations and wage moderation characterise the German economy of the past twenty years, with considerable increases in flexibilisation and wage bargaining power moving to work councils and thus the factory level (Baccaro and Bonassi 2017). The weakening of trade union and employer association membership density

which had started as a result of the economic situation after German unification had thus eventually (and in complex ways) contributed to increases in competitiveness under conditions of the single currency. The country that had started the new century as the “sick man of Europe” had thus enjoyed an “exceptional recovery” (Marin 2018), led substantially by export performance.

3 Theorizing the German trading state

What theoretical perspectives does political economy hold to understand the specifics of the German trading state and its successes? Looking at the literatures on comparative politics and comparative political economy, we find that several approaches promise to enable a better understanding.

In the literature on international relations, both the concepts of the “trading state” and of “civilian power” have been put forward with special (if not exclusive) reference to the German case. The theory of the “rise of the trading state” (Rosecrance 1987) reflects on the changes in the international system after 1945, pointing out that theories of international relations still saw borders, territory, sovereignty, independence and military power as key concepts and had neglected to reflect the rising importance of trade. Evidence showed, Rosecrance argued, that many smaller (e.g. European) states had achieved substantial economic growth by following a strategy of expanding their share of foreign trade relative to GDP. Rosecrance argues further that a shift of relative costs lay at the heart of this new strategy – an increase in the (political and financial) costs of warfare and armament and a lowering of the costs of attempting trade success through the introduction of a well-functioning liberalised world trade regime after 1945. While the author emphasizes the dynamic, the openness and the potential reversibility of that process, he also points out the success that countries like Japan and Germany have had, following a strategy concentrating on trade and reducing spending for the military.⁸

Contrary to the shifting relative costs argument advanced by the theory of the trading state, the concept of the “civilian power” is rooted in the constructivist school of international relations and focuses on foreign policy role concepts that states have. Put forward by scholars such as Hans W. Maull (1990, 2007), the focus (with reference to the work of Norbert Elias) is on attempts to civilise policy and in particular international relations. The concept is put forward with particular reference to Germany and Japan, two countries that after defeat in World War II refocused from the pursuit of military power to economic and trading power. In the case of the Federal Republic of Germany, the foundation for this fundamental shift lies in the decision for *Westbindung* during the East-West conflict following World War II and a conscious break with the German past. Military security was no longer to be organised nationally, but

⁸ The period in which this theory was developed – the 1980s – was one in which the United States underwent economic problems (stagflation, rising budget and trade deficits), while Germany and Japan were economically much more successful.

multinationally through NATO and inclusion in European integration – an idea that has strong support both in the foreign policy elites and the general population. The successful unification of Germany was seen by many as the empirical proof of the appropriateness of this strategy. However, the author makes clear that this concept requires a supportive international context, such as a commitment to multilateralism by the country’s most important partners (who partly co-guarantee the military security of Germany).

Theoretical approaches to the German trade profile from comparative political economy instead put the focus on institutions. From this perspective, the German “variety of capitalism” as well as its trade profile are strongly influenced by specific characteristics of the country’s political economy and its institutional characteristics. Many authors have described and analysed the specifics of the German political economy over the decades (Shonfield 1965; Katzenstein 1987; Albert 1993; Hall and Soskice 2001; see also Iversen and Soskice 2010). An overarching theme is the existence and important role of non-market mechanisms of coordination among firms and the complementarity of sub-systems in the “Rhenish capitalism” or “coordinated market economy” of which Germany is a typical case. Banks are the main source of funding for firms, and they provide “patient capital” in return for influence through seats in supervisory boards. Independent of the need for maximizing short term profits, firms can pursue long-term strategies, which allow them to offer employment security to their employees. This in turn provides an incentive to the workforce to invest in their own human capital through constant re-skilling. Cooperation between firms through powerful associations ensures that training standards provide employees with a good mix of general and firm-specific skills, which enables firms to offer them secure employment, to focus on quality and pursue a strategy of incremental (rather than disruptive) innovations. “Diversified quality production” (Streeck 1991) is the hallmark of their products, which compete on quality rather than price. They are highly competitive in a wide range of international markets because of reliability in quality and price stability, the latter being achieved by tight monetary policy and moderate trade unions which know that stable unit labour costs is a precondition for (export) success. Such a system displays a number of strengths that can be understood as institutional advantages when compared with those of other countries. From this perspective, German trade performance can thus be interpreted as the exercise and nurturing of a specific comparative institutional advantage.

4 Economic imbalances? The domestic and international debate

The German economy’s export orientation and success, however, not only have economic advantages as well as disadvantages (as argued above), but they are also politically ambiguous since they are both the source of political influence and dispute. Internationally, the massive current account surplus Germany has been running since the early years of this century have led to criticism and calls for change. In this section, I will outline the political disputes over the

issue, both domestically in Germany and between Germany and her partners. Before we do so, let us start with a brief refresher on the terminology of national accounting.

The system of national accounting in economics is one of double-entry book keeping where every transaction is entered with a balancing financial entry. Overall the balance of payments is thus always zero and imbalances can only occur in its constituent balances. The most important ones are the *current account* (which adds up the sum of exports and imports in the areas of goods and services plus income from abroad plus current transfers) and the *capital account* (which adds up foreign direct investment, portfolio investment in shares and bonds plus other investment plus reserves in foreign currency). In political discussions, the focus is mainly on the *current account*. If a country has a current account deficit, it means that it absorbs – through consumption, investment and government spending – more than it produces; if it has a surplus, it absorbs less than it produces. Both has effects on other countries: the former is only possible if the country gets credit from abroad or runs down its foreign currency reserves; the latter means that a country increases its foreign assets. Figure 1 shows the development of current accounts in per cent of GDP for the G7 countries plus the Eurozone from 1990 to 2016, with numbers added for the German case.

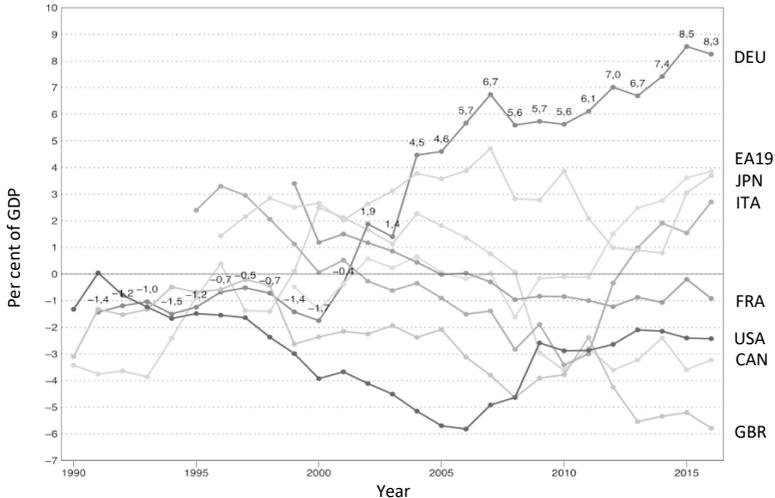


Figure 1: Current account in per cent of GDP, 1990-2016
Source: OECD

As we have seen above, the Federal Republic has traditionally been a country of current account surpluses, from which in recent decades the only exception was in the 1990s (Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung 2014, 221). After the disruption brought by the consequences of German unification, Germany between 2005 and 2016 displayed a high surplus averaging around 6.5 per cent of GDP per year. As a

result both domestic and international debates about the surplus ensued on whether there is a need for a correction, and if so, what shape it should take. Let us first consider the domestic debate.

The domestic debate about the current account surplus has been lively, but strongly influenced by the orthodox position taken both by the *Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung* (SVR; Council of Economic Advisers) and the *Bundesbank*. Both essentially argue that surpluses are no problem, since they reflect decisions by the private sector both in Germany and abroad. As the result of market processes, they do not constitute distortions by economic policy and hence, the argument goes, there are no grounds for policy intervention. The SVR also refutes arguments that a weakness of public investment exists in Germany, and cannot agree with the criticisms brought forward by the European Commission regarding the surplus (Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung 2014, ch. 6). The SVR enjoys a lot of authority in German public discourse, and it has been pursuing this line of argument consistently over the years, as statements from the late 1980s (when then West Germany also had large surpluses) show. The *Bundesbank* argues similarly that developments of the current account reflect a multiplicity of developments and decisions – among them demographic change – and the high level of competitiveness German firms enjoy on world markets. Attempts at policy intervention are disapproved of, since they are seen as unlikely to succeed and might even be counterproductive (Deutsche Bundesbank 2013, 43-65).

Some respected economists have shared their disagreement with that position. They argue that the orthodox position downplays the influence of fiscal policy on the surplus and that change above all is necessary for foreign policy reasons, to avoid the perception of Germany trying to dominate Europe by economic means (Hellwig 2017; see also Bernanke 2015). Already several years ago, former chancellor Helmut Schmidt made the point of emphasizing the negative foreign policy consequences of the surpluses, especially against past European experiences with Germany. The surpluses, Schmidt argued, contradicted the *Stability and Growth Act* of 1967 which calls for a balance in foreign trade. If continued, they might lead to German isolation, not least because the flipside of surpluses are deficits in other countries (Schmidt 2011). The latter is a position shared by many on the political left who (to a varying degree) make German export successes responsible for economic problems in deficit countries and thus (e.g. the Left Party) call for an abolishment of state export credit guarantees.

This opens the way for the consideration of the international part of the debate. International organisations (such as the IMF and the OECD) acknowledge the economic success of Germany, but argue that adjustments are necessary. The IMF sees strong employment growth, low unemployment, output growth above potential and a strengthening fiscal position as positive, but wage growth and core inflation as “too low”. While acknowledging that demographic factors play a role in the surplus, more public investment, less personal saving (which is linked to a German pension reform suggested by the IMF) and rising wages are seen as necessary

antidotes. The IMF also points out that German authorities time and again emphasize the market origin of the surplus, thus classifying it as not caused by political distortions (International Monetary Fund 2017). The OECD drew attention to the necessary correction of “unsustainable imbalances” in the Euro area early on, but (like the IMF) acknowledged that in the case of Germany, fundamental factors such as demographic change can account for part of the imbalance (OECD 2010). Other analyses do not advocate change, but rather cautiously note that suggested policy changes would “also reduce its external imbalance to some extent” (OECD 2016, 22).

The *European Union* took up the issue of the current account surplus and conducted an In-Depth Review (IDR) of the German economy in 2013/14. IDR is a part of the *Macroeconomic Imbalance Procedure* (MIP) that the EU had introduced after the financial markets crisis to improve the monitoring of national situations. With an average current account surplus of 6.5 per cent between 2010 and 2012, Germany had exceeded the warning level of 6 per cent. If the MIP diagnoses an “excessive imbalance”, the Commission can take steps in the form of an *Excessive Imbalance Procedure*. However, this was not the result in the German case. The Commission’s report conceded that “a current account surplus is in line with the structural characteristics of the German economy”, but points out that its pace of accumulation and its persistence even during a time of adjustment are unusual and may be a sign that imbalances ultimately detrimental to German economic welfare may exist (European Commission 2014). However, taking the position that current account surpluses are less worrying than deficits (because there are no problems of funding them), the Commission had already decided in 2011 that they should not be sanctioned. In its 2017 European Semester country report, however, the Commission pointed out that Germany had only made “limited progress” in addressing past country specific recommendations (European Commission 2017).

The German federal government had to relate to this debate in some way, but found taking sides somewhat difficult. Let us briefly reflect on the government’s strategic situation and start by imagining a map of the positions described above on a continuum between a “market” perspective (which sees the surplus as caused by private sector market decisions against which little can – and should – be done) and a “policy” perspective (which sees the surplus as in principle amenable to influence by policy decisions). Both extremes (the end points of the continuum) bring problems: Subscribing to the “policy” position would imply taking responsibility for the surplus. As a consequence, the government would have to heed calls for a changed policy stance with respect to investment and wages, even though it might have difficulties implementing them – given how German federalism works and that the government’s influence on wage setting in the private sector is small. Emphasizing the “market” position might be politically popular (stoking pride in being “export world champion”), but risks antagonizing especially the European partners whose patience might run out at some point. In addition, the surplus might create serious problems in the future, so that taking some measures for balancing it might be advisable both economically and politically.

So far the German government has thus opted to pursue both positions to some degree. Reacting to US pressure – such as claims that the German surplus meant a “deflationary bias for the euro area, as well as for the world economy” (U.S. Department of the Treasury, Office of International Affairs 2013) or suggestions by the Trump administration of exchange rate manipulation – the government has emphasized the market nature of the surplus and the competitiveness of German firms, and it has pointed out that most of the causes (such as the exchange rate, demographic factors, an advantageous structure of goods produced etc.) are beyond the influence of government action (Bundesministerium für Wirtschaft und Energie 2017b). However, at the same time the government has started a “National reform program 2017” as a reaction to the EU Commission’s complaints about the current account surplus. In this program, it reports that measures have been taken to strengthen domestic demand, thus working to lower the surplus. Measures like the introduction of the minimum wage are also being mentioned, as are alleged increases in public investment which are claimed to have risen by 40 per cent on the federal level during the 2013-2017 parliament (Bundesministerium für Wirtschaft und Energie 2017a). But these claims and numbers leave the impression of having been put together in the most favourable light and mainly for foreign consumption. Because for any observer of German politics it is clear that e.g. the minimum wage was a result of a long-standing domestic policy dispute resolved in the coalition agreement of the 2013 Grand Coalition and not a measure to balance the current account.

Evidently the question of preserving or rebalancing the current account surplus is a deeply political one. Different groups have different interests and preferences regarding this topic. Any substantial change is going to impose costs on some actors, and thus it can be interpreted as a distributive struggle (Frieden and Walter 2017). How these costs will be shared between different domestic groups or whether they can be externalized remains to be seen. Given the overwhelming interest of Germany to preserve the existence of the Eurozone, the government will need to balance competing domestic interests and find a policy mix that can avoid the worst possible outcome for all, namely a breakup of the Eurozone.

5 What (if anything) can be done?

Given the need for action, the obvious question is: what can be done? We conclude this paper with a section that parses the various recommendations and options previously discussed and tries to assess their economic and political viability for reducing the tensions caused by the German current account surplus. In discussing these options, we are not taking sides in the dispute between the “market” and the “policy” perspective described above. Rather, we want to discuss the viability of the various suggestions under the assumption that policy makers had decided to try to influence the situation and were now looking for the appropriate tool.

Let us start with the recommendation that Germany should increase wage rises so as to both have higher unit labour costs and increase domestic demand (e.g. Bernanke 2015).⁹ While from a purely economic point of view this is a correct recommendation if one wants to reduce the current account surplus, it ignores the fact that wage restraint is a conscious choice by the German trade unions and employers, aiming to secure German competitiveness on world markets. As long as both sides of industry stick to that voluntary strategy, there is no way in which they can be forced to abandon it – because the German state has no leverage over it. If the German government were convinced that this is the right way, it would face the problem that its share in public employment is about ten per cent of overall public employment. Any steeper wage rises would be both costly and have little overall effect.

Conscious of their voluntary choice, German trade unions recommend that the current account surplus should be balanced by more public investment (Bundesvorstand 2015). According to their analysis, a main reason for the surplus lies in underinvestment and a resulting import weakness. Therefore private as well as public investment should be increased to improve weak domestic demand. This is, so the trade unions, a political task, demanding a U-turn in political strategy aimed at balanced public budgets. Such a strategy ignores the popularity that a stability-oriented policy enjoys among German voters, and it is thus similarly unpolitical as the recommendation for wage restraint. By absolving themselves completely of any task in the rebalancing, the trade unions are quite clearly more part of the problem than of the solution.

Recommendations for deficit spending have also been put forward, but they run into the same problem as calls for more investment. In particular, given the current German labour market performance with quite low unemployment, and an economy running almost at capacity, problems might arise in terms of rising inflation. While this might be quite functional from an economic point of view, it is quite clear that such a strategy would run into substantial political opposition, especially given recent worries about economic stability that have manifested themselves in the electoral successes of the *Alternative für Deutschland* (that started its life, not to be forgotten, as a party calling for more stability oriented economic policy during the Euro crisis in 2013).

Policies increasing growth prospects in other European countries would probably be helpful, because they could increase current account balances in these countries (see e.g. Kollmann et al. 2015). However, if they were to be conducted through supply side and structural reforms (such as abolishing labour market blockades etc.), they would likely run into (potentially severe) political problems which might make them unattractive to consider; if they were to aim at increased spending, they might conflict with European level agreements concerning deficit spending. A way out of the latter would be a coordinated reflation strategy similar to that of the

⁹ Insufficient domestic demand, coupled with allegedly weak purchasing power “of much of German society”, is also linked to the current account deficit (by Jacoby 2017, 20) who sees the need “to rely heavily on external demand” as a consequence. But the factual basis for that claim is weak: while meagre domestic consumption had been a problem in the past in Germany, in recent years it has been growing healthily in line with GDP and can no longer be considered insufficient (cf. OECD 2018, 29).

1978 G7 Bonn summit. However, even if one were to advocate that and ignore the questionable results back then (Putnam and Bayne 1987), this seems unlikely given the present state of economic preferences and transatlantic relations.

6 Conclusion

So, what remains to be said? It seems that none of the remedies discussed to ease the German current account surplus are easy to implement or promise to be an effective solution – and that assumes that one shares the analysis of the surplus being a serious economic problem. But even if one does not, the above should have made it clear that perceptions of political dominance by Germany pose a serious threat to both the continued existence of the Eurozone and ultimately even the European Union. And this at a time, when the global political situation seems more serious and threatening than it has in a long time.

Germany, it seems by way of conclusion, has been switching relative institutional advantages. During the era of the *Deutschmark*, Germany had the relative advantage of the *Bundesbank*. With its massive anti-inflationary credibility, it was “the bank that rules Europe” (Marsh 1993). One main point of Germany’s partners opting for currency union was to get rid of the *Bundesbank*’s dominance, because the *Bundesbank* focused only on outcomes for Germany (as it was required by law) and ignored the interests of other European countries (which were, however, heavily influenced by its actions).

Once the Euro and the ECB had been introduced, Germany (in spite of the latter being modelled on the *Bundesbank*) went through a rough patch and experienced disadvantages first. After a couple of years, however, another comparative German institutional advantage became dominant, namely that of being much better able than most of her European trading partners to keep unit labour costs in check. This is both due to the corporatist structures and thus institutional ability of the German wage bargaining system to act in a coordinated way (Johnston et al. 2014), and to the trade unions’ choice of wage restraint. Recent change in the system, in spite of being looked upon with great scepticism before by a number of observers, has turned out to improve that capability even further (Baccaro and Benassi 2017). German labour, it seems, is exchanging safe employment (in its relatively oversized manufacturing sector, but not only there) for a renunciation of maximising wage proceeds. This is a strategy that, thirty years ago, was termed “socialism within one class” (Scharpf 1987). Back then, Scharpf was incredulous that this strategy could be successfully implemented to guard against mass unemployment. Today, things seem to have changed. To what extent this constitutes progress, especially for the trade unions, will require further investigation. It may well turn out that Scharpf’s old dictum still holds true, namely that “as so often in the history of the labour movement, again the theoretically legitimate strategies were not feasible and the feasible practice not able to be legitimized.” (Scharpf 1987, 331). Any hope for quick and decisive

change in this area, that much of the literature on comparative institutional advantages and their persistence and stickiness can teach us, is likely to be futile.

Political strategy change could nevertheless come about by means of an expansionary fiscal policy. As mentioned above, claims about a situation of public underinvestment in Germany are being advanced by many sides (if disputed by some), and ongoing discussions about the state of the country's schools, streets and telecommunications infrastructure are cases in point. However, German fiscal policy has been fetishizing the "black zero" (*schwarze Null* – meaning a balanced or slightly surplus state budget) for many years, with considerable popular support. From a political-economic standpoint it is clear that this is not an optimal strategy (see the discussion in Haffert 2016), but CDU, FDP and most SPD politicians have so far blocked a discussion about strategy change towards a more expansionary fiscal policy. The commitment towards a balanced budget was even constitutionalised under the (heavily normatively laden) name of the "debt brake" in 2009. Before this substantially ingrained policy position can be changed, a massive discursive effort will have to take place – and win a majority following. So far, little points to e.g. the Social Democrats being prepared to shoulder that task.

We thus arrive at a conclusion similar to that of other authors (e.g. Armingeon and Baccaro 2015; Jacoby 2017) in diagnosing a situation that can be likened to a blockade, and one that – in the long run – has the potential to undermine the foundations on which Germany's economic success depends. This is not only politically and economically an unsatisfactory situation; it is also unsatisfactory from an academic point of view. For it seems that a much better understanding of the German political economy is needed. It seems questionable whether political economists' ideas about how Germany functions are still in touch with reality. Much of what we seem to know in this area rests on analyses dating back decades, like the arguments developed by Shonfield (1965), Katzenstein (1987) and Hall and Soskice (2001). "Deutschland AG", the closely-knit community of big enterprises and mighty banks engaging in "organized capitalism" in partnership with a *semisovereign state* and centralized, powerful trade unions, however, has been subject to change in the last two decades (Höpner 2004). Organisational density has declined, both on the trade union and the employer side. But clearly this has not been the terminal decline for *Modell Deutschland* diagnosed by some, because the system is still able to deliver collective goods central to its success, such as wage moderation. So we must ask what has replaced "Deutschland AG"? What are the mechanisms that coordinate and synchronise the German political economy as it moves into the second quarter of the 21st century? Here, today's academic political economists clearly have some homework to do before they can come up with models and explanations that are as convincing and parsimonious as those of their predecessors. And this task is the more urgent the more dangerous – politically or economically – the present situation of the German current account surplus is held to be.

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