# How To Get Rid Of Germany's Excessive Current Account Surplus

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There's no end to the criticism of the excessive German current account surplus. Quite rightly, people suggest that this imbalance has the potential either to unleash violent currency fluctuations on a global scale or to generate a renewed debt crisis in the Euro Area. The consequences of such disruptions would also substantially damage the German economy. So, the question becomes more urgent: what contribution can Germany itself make in overcoming these economic troubles.

The demand is frequently made that wages in Germany should grow more strongly than up till now. The hope is that this would raise the price of exports and, thereby, foreign demand for German goods would drop. This alone would reduce the surplus in the current account. There would be an even stronger effect on the import side of the equation. This stronger wage dynamic would make incomes rise more powerfully. That in turn would raise domestic demand for imported goods, again reducing the surplus.

All these considerations are quite right in themselves. But the hopes bound up with this strategy that a more stable current account will emerge are way over the top. What's more, the prime purpose here cannot be to moderate German exports but to raise imports. More powerful pay increases – as an IMK study shows – are simply not enough on their own to significantly cut the imbalance over a reasonable period of time.

The reasons for this rest in an incomplete understanding of the effects that accelerated pay increases bring about. As mentioned above, it's not enough to factor in the effects on export and import volumes. The current account is a nominal concept that embraces both – effects on prices as well as on volumes. The surplus can be measured in the final instance in the difference between export yields and import expenditures.

Here we can see the first obstacle to any substantial adjustment. Higher wages lead to higher export prices and in Germany's case this brings – because of the inelastic reaction in export demand to price rises – in the short term at least increased export yields despite declining export volumes, thereby working in the direction of an even higher surplus. Even the positive effects on imports are exaggerated. This lies with the very close integration of Germany in the global economy. Many export goods rely, meantime, on imported inputs. But this means that declining export volumes, taken by themselves, also bring declining import volumes. This counteracts the workings of higher incomes on stimulating imports and dampens their effect. In the final analysis, export yields do not drop to the extent one hoped for nor do expenditures on imports rise strongly enough to bring the current account into balance.

Are higher wage increases the wrong recipe, then? Absolutely not, they're just not enough on their own. They require rather to be accompanied by measures on the fiscal policy side. And this is even possible without it being necessary to break the strict German rules on debt.

Higher pay increases bring with them increased income for the state. Taxes as well as social security contributions increase markedly with higher wages and incomes. The position of public budgets improves substantially.

If federal and federal state (*Land*) administrations, along with local councils, decide not to use this extra income to consolidate their finances but for (re)spending this would create a decidedly stronger impulse towards a more balanced current account. This impulse coming from the state works, moreover, on a continuous basis unlike a pay-rise. Part of increased government demand flows directly into imports, another part has an indirect effect through the impact it has on further increases in household incomes. This occurs without, as with wages, counter-effects such as export price increases or negative import reactions taking place.

The combination of dynamic pay increases and expansive fiscal policy therefore takes the current account a good deal further back into balance even if it takes a wee while. Even more is possible on a temporary basis. For the pay rises assumed in simulations remain so moderate that they do not lead to any redistribution in favour of wage-earners. This would, however, be helpful for a limited period. Equally, the state could temporarily – as excluded from the simulations – run up against the legal limits it sets on its debt. Taken together both would perceptibly accelerate the process of slashing the imbalance in the current account. So, Germany has it in its own hands to deal with its external imbalance ensuring greater stability at least within the Euro Area.