Policy options against macroeconomic imbalances within the EMU – how to address the surplus countries

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1 Research questions

2 Overview on the main surplus country

3 What has caused the German surplus?

4 What is the problem with Germany’s surpluses?

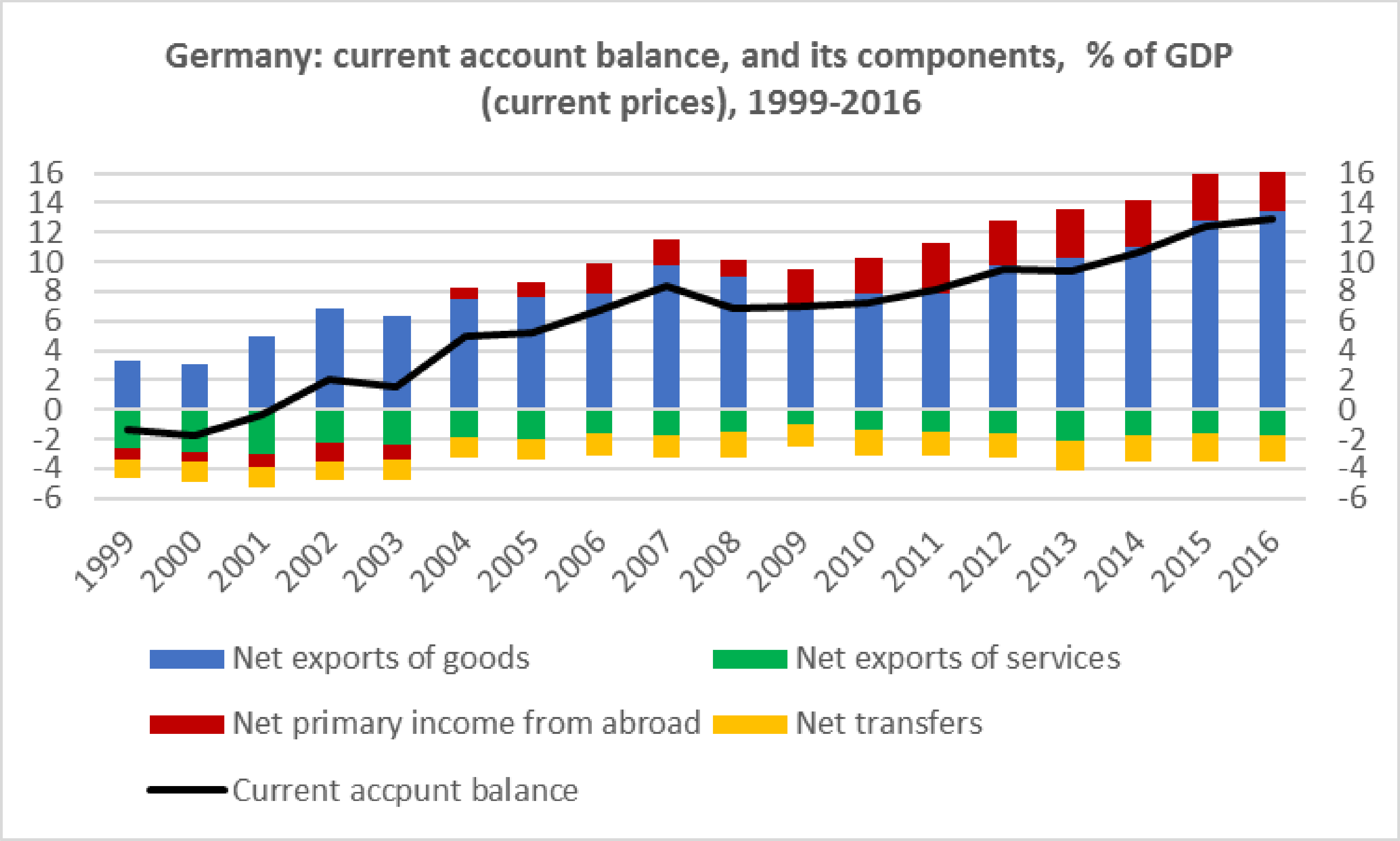
5 Trade balance projections 2016-2026

6 Policy options

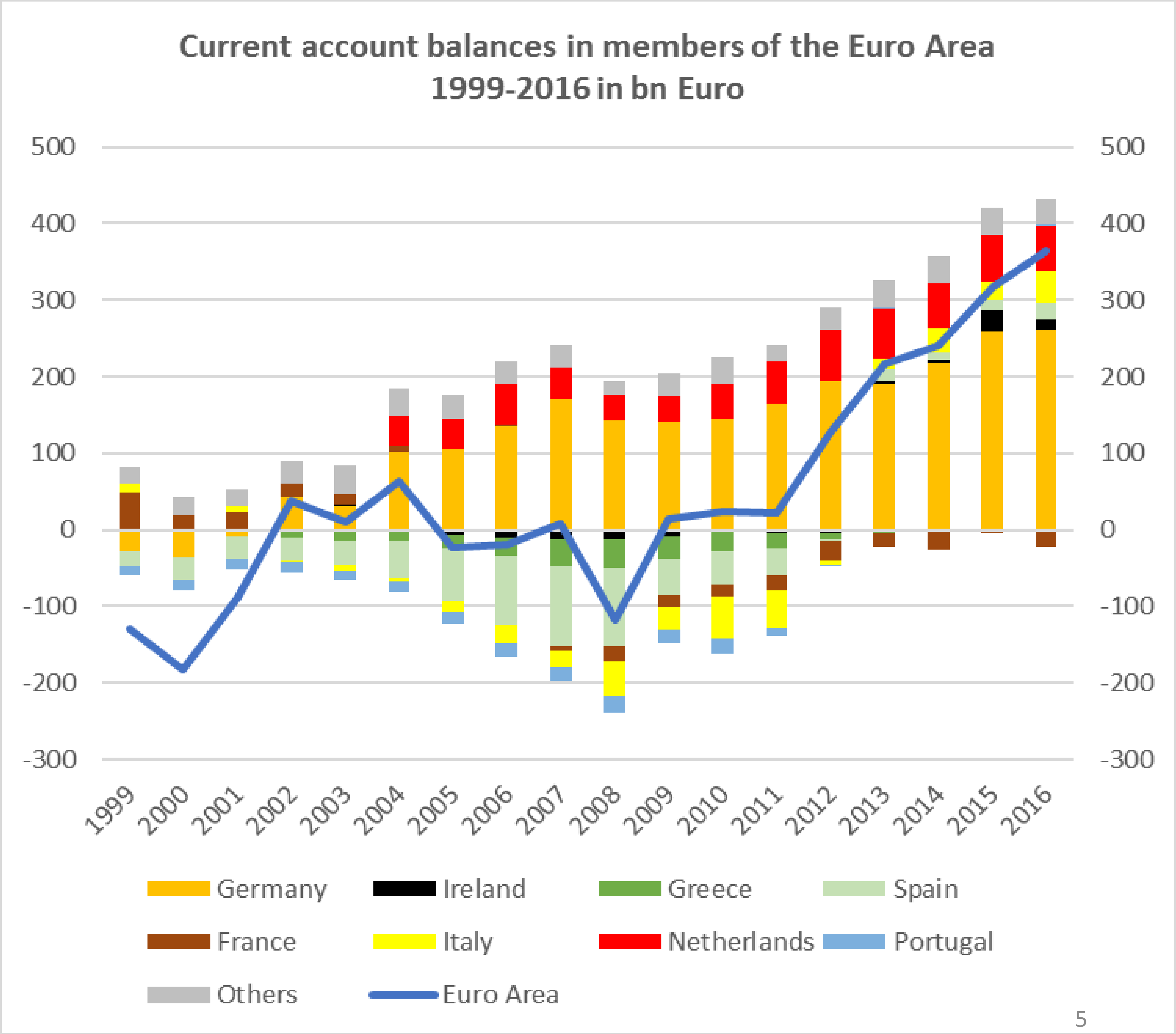
Research questions

- Understanding the main surplus country
- Sorting out what the key problems are with the imbalances
- Search for policy proposals addressing mainly the surplus countries

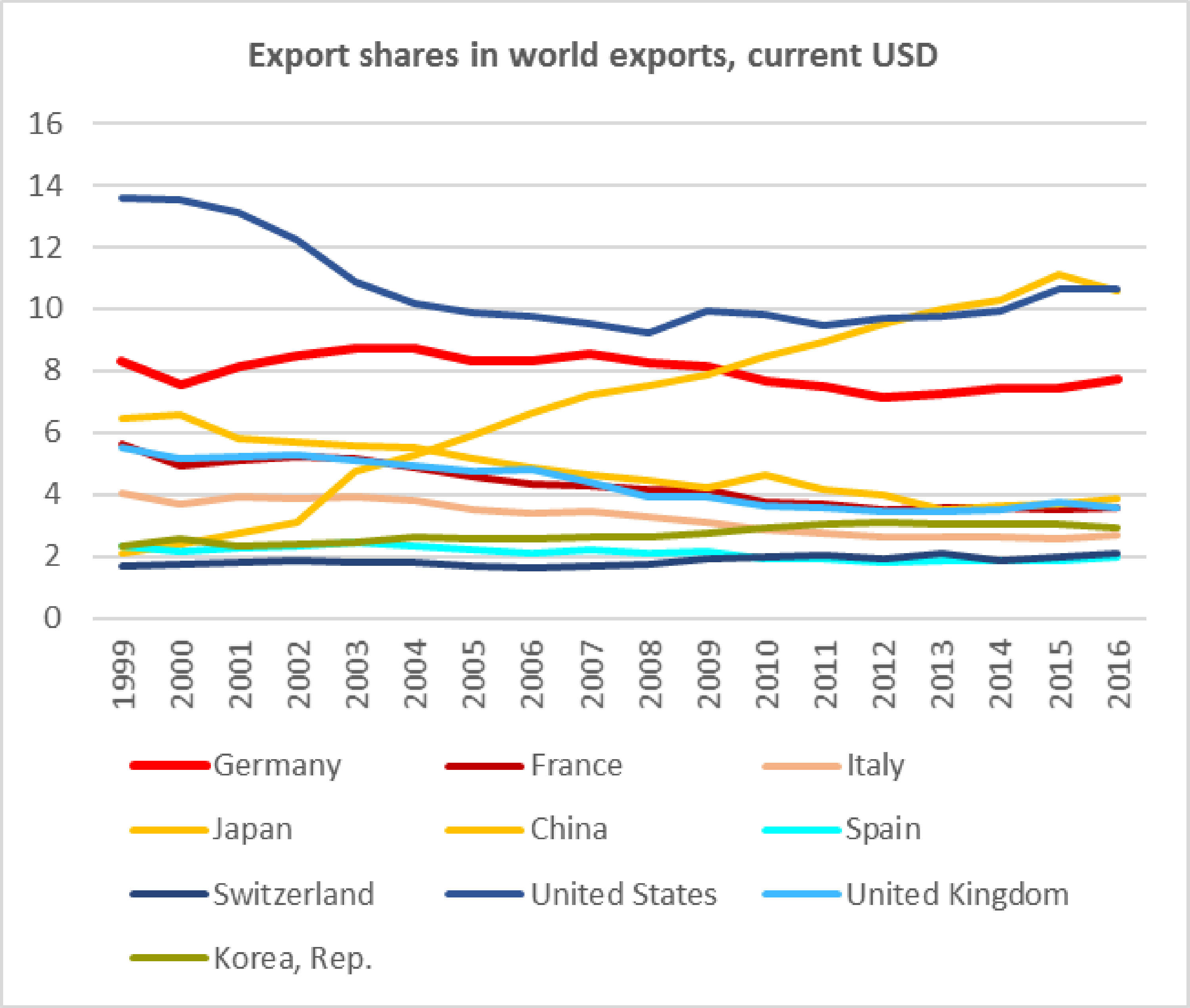
Overview on the main surplus country



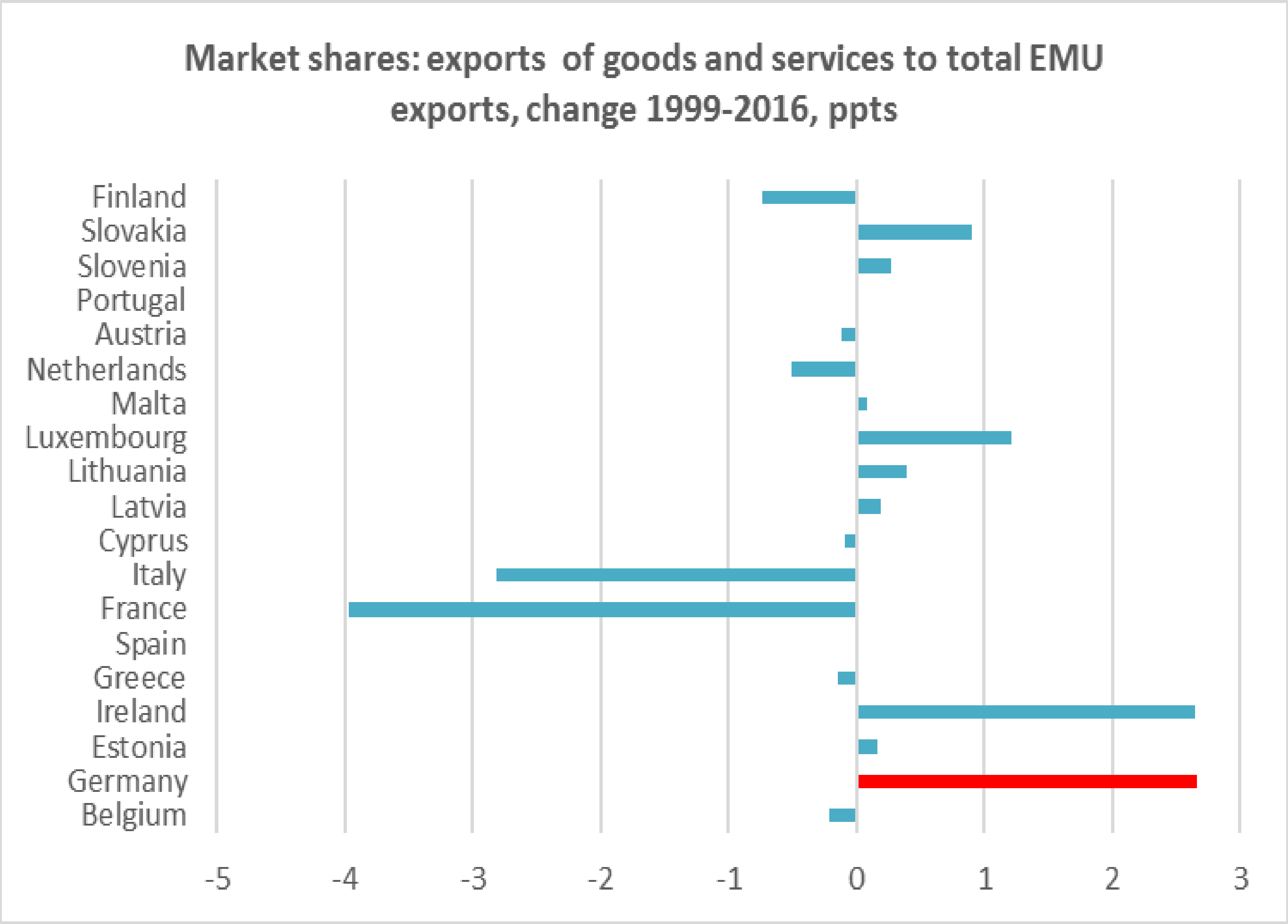
Almost all deficits have faded, external surplus rose



Note: US- and China share look stronger because of strong US$ after 2008



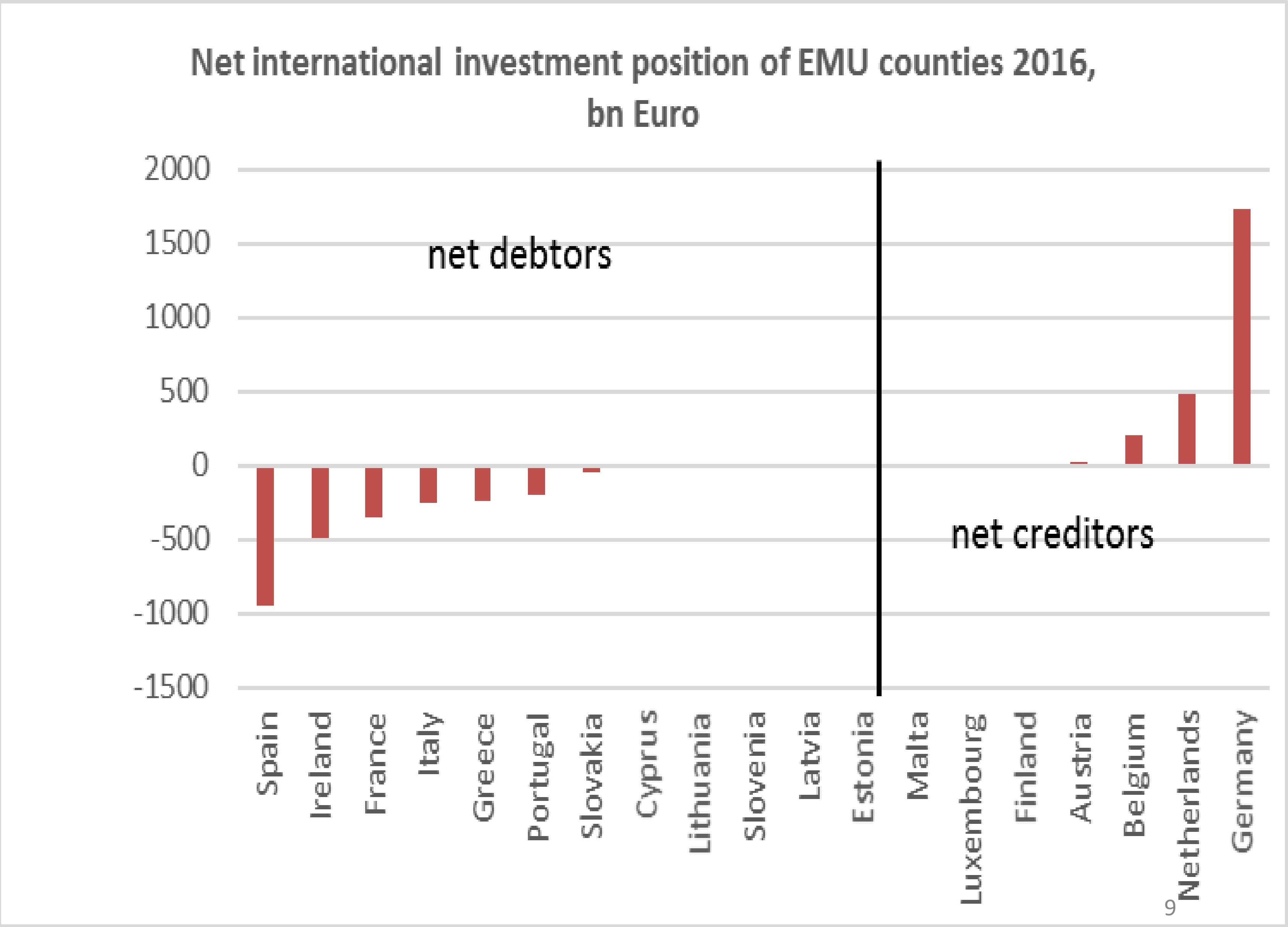
Main winners and losers in EMU exports market shares 1999-2016:
+ DE, IRE, Lux
- F, IT, FL



Massive and divergent structural changes

	Change of exports/GDP ratio, %	Exports/ GDP ratio, %	Change in manufacturing/GDP, %	manufacturing VA/GDP, %
	1999-2016	2016	1999-2016	2016
Luxembourg	74,2	228,8	-48,6	5,5
Germany	70,2	46,0	1,3	22,6
Portugal	52,1	40,3	-24	13,6
Greece	49,7	30,1	-7,9	9,8
Latvia	47,4	58,0	-18,0	12,5
Ireland	38,3	119,9	38,4	36,7
Netherlands	33,8	80,6	-22,6	12,0
Austria	32,4	52,3	-7,4	18,7
Belgium	32,0	84,8	-26,9	14,2
Italy	29,0	30,0	-18,0	10,1
Spain	25,3	33,1	-21,3	14,1
France	14,6	29,5	-29,6	12,0
Finland	-6,0	35,4	-36,8	16,6

Power shift: Germany became THE BIG net debtor nation



What has caused the German surplus?

A. Growth of x > growth of M

Growth of value of exports: $\hat{}XV = f(\mathbf{y_w}, p_w, t, \boldsymbol{\varepsilon_{wy}}, r\hat{e})$

Growth of value of imports: $\hat{}MV = f(e_{\$€}, \mathbf{y_D}, p_w, t, \boldsymbol{\pi_x}, \boldsymbol{\pi_D}, r\hat{e})$

Export „problem“: high price and structural competitiveness

Rising export market shares, globally and in EMU

Other countries deindustrialised

import problem:

~ 50% of imports are import content of exports

- rest of imports depends on weak dynamics of domestic demand
- Broad manufacturing base

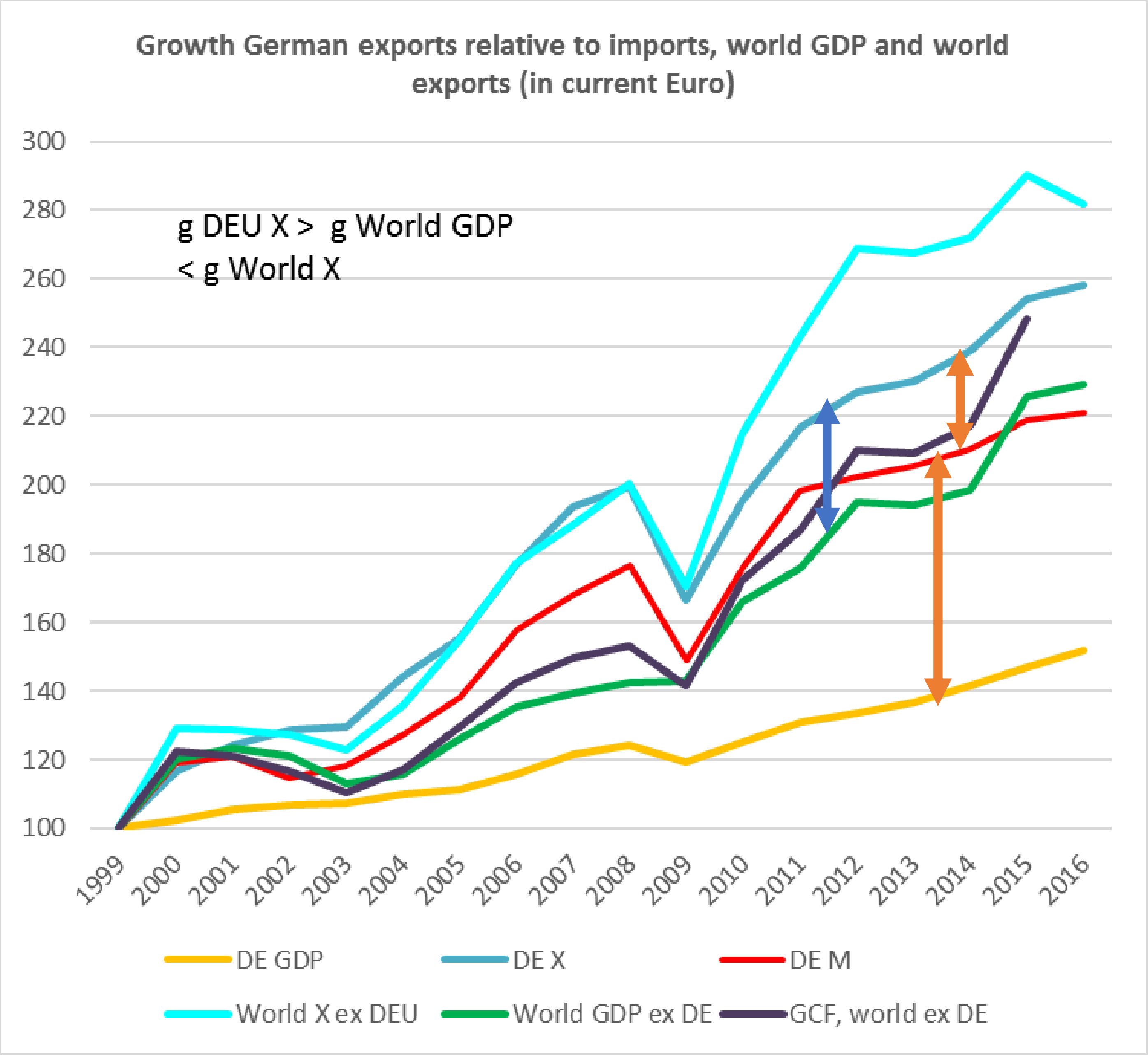
Long-standing structural change towards exports and focus on manufacturing

B. Current account = total saving of all sectors - investment

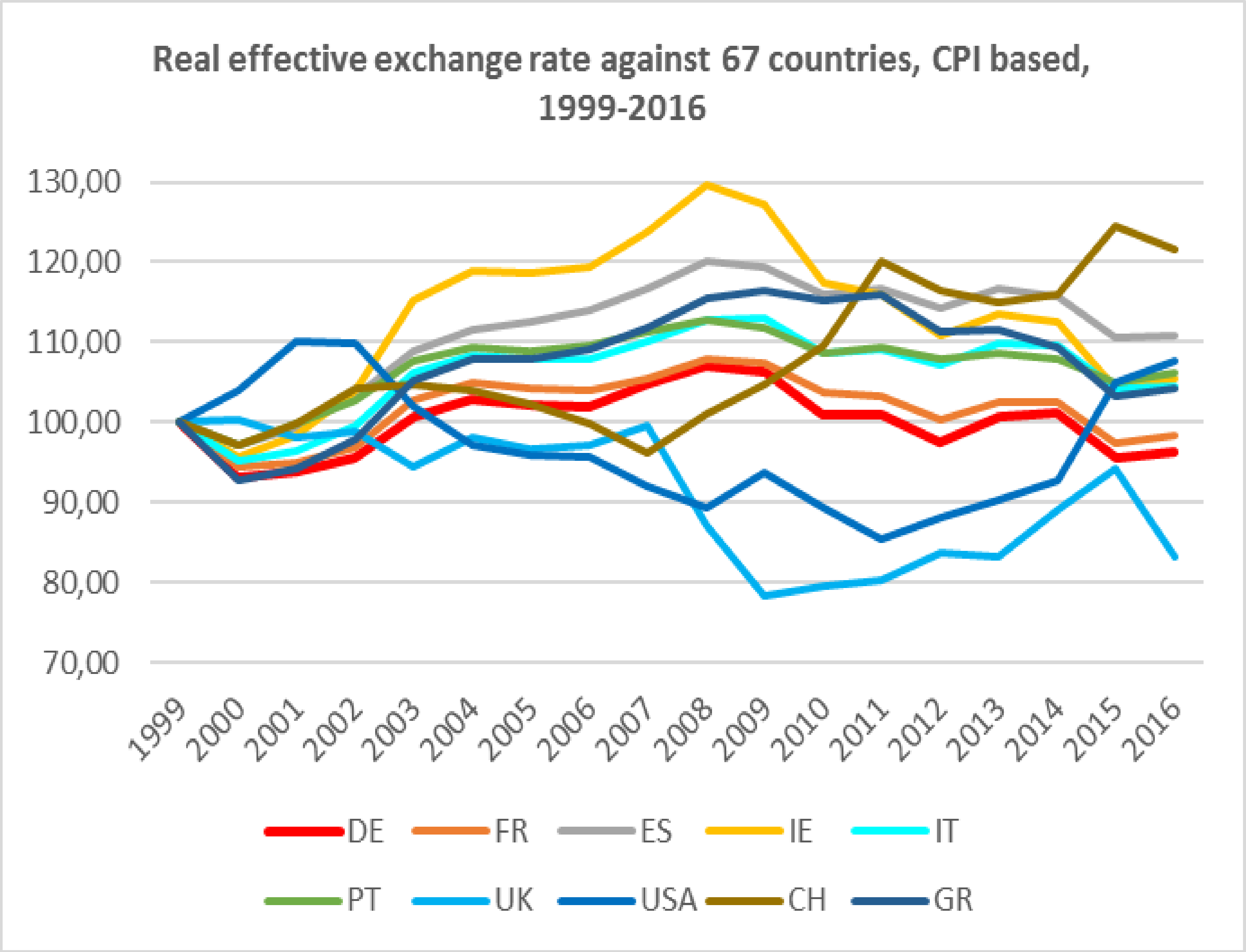
Exports and imports diverge

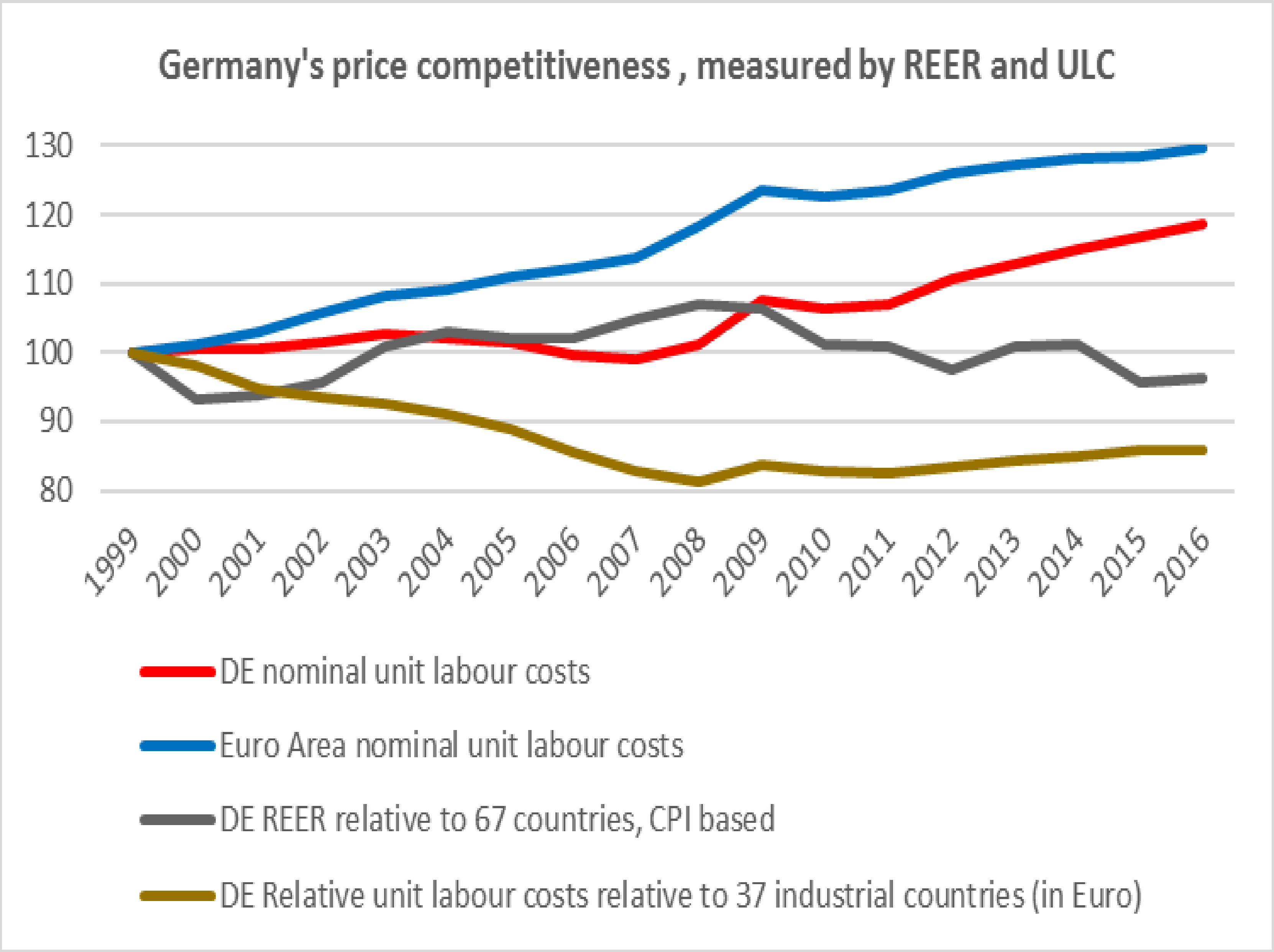
Growth rates p.a., 1999-2016

DE GDP 2.5%
DE imports 4.8%
World GDP ex DE % 5.0%
DE exports 5.7%
Gross capital formation world ex DE 5.9%
World exports ex DE 6.3%



Exchange rates and unit labour costs play a role, but … more indirectly

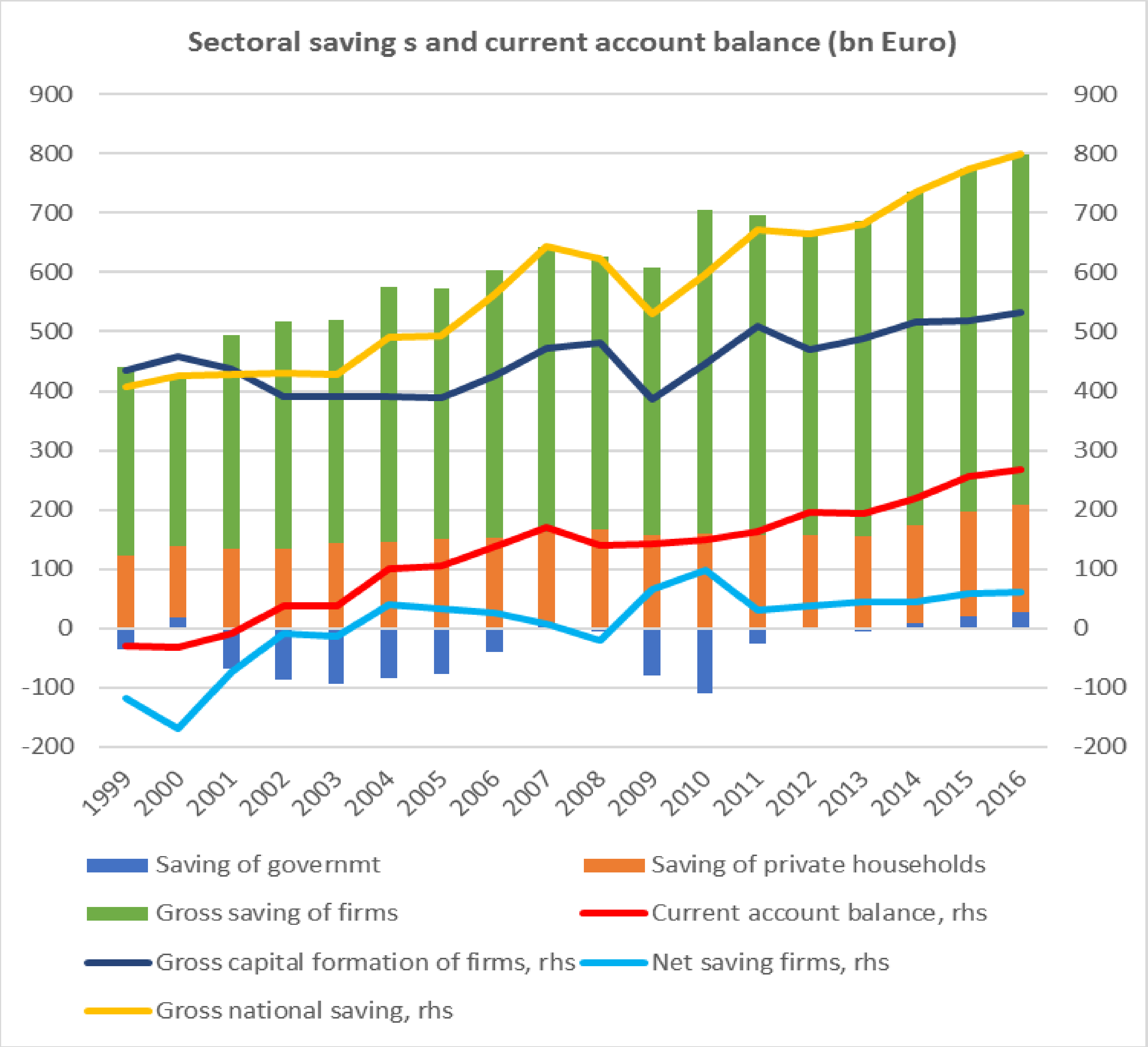



Germany's price competitiveness , measured by REER and ULC
130
120
110
100
90
80
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
DE nominal unit labour costs
Euro Area nominal unit labour costs
DE REER relative to 67 countries, CPI based
DE Relative unit labour costs relative to 37 industrial countries (in Euro)

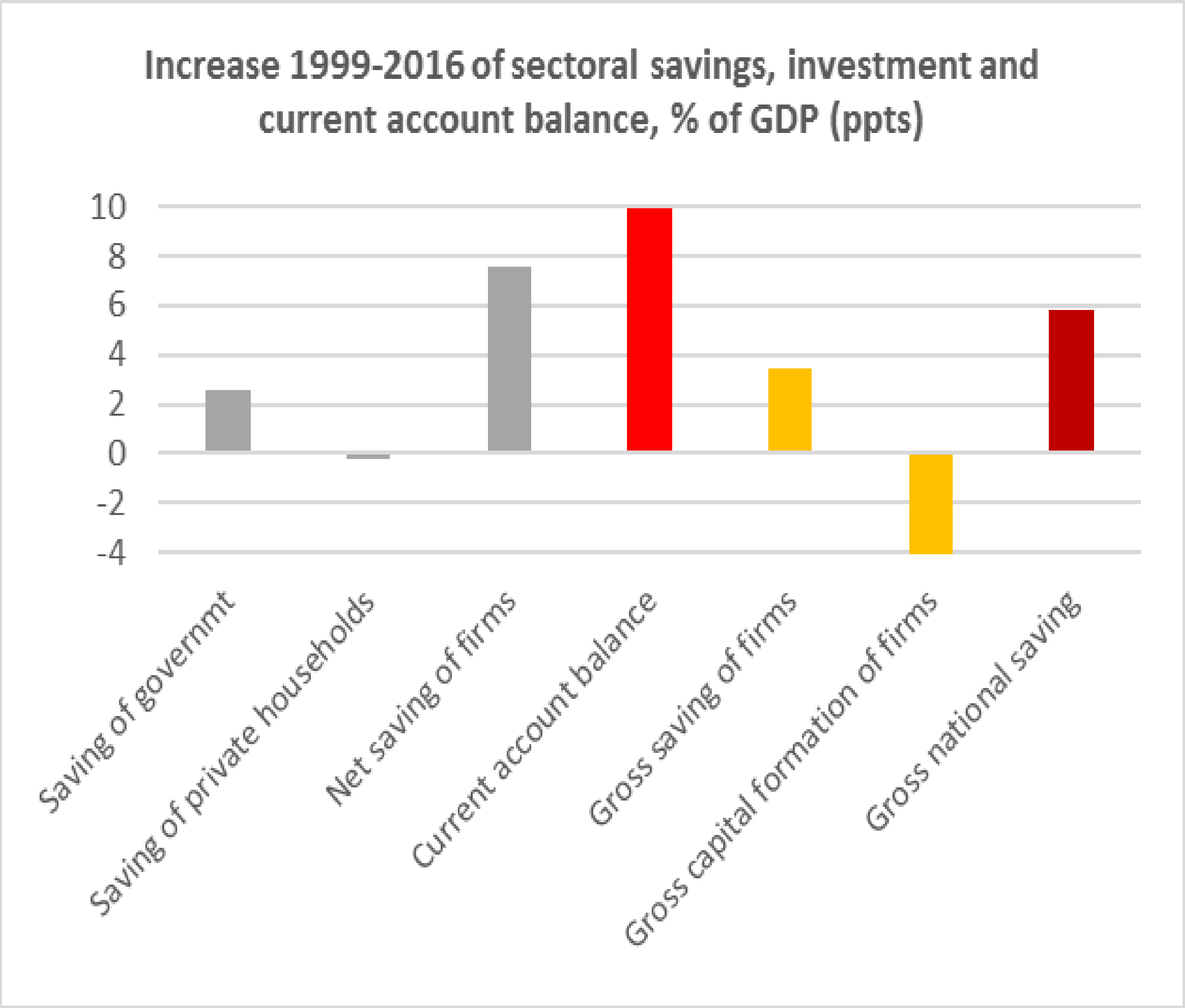
Savings rose relative to GDP

$CAB = S - I$

$S = S_{HH} + S_{Gov} + S_{firms}$



Increase CAB/GDP 1999-2016 mainly due to
- S_{firms}
reduced investments
- and S_{gov}



Explosive matter - trade balance projections 2016-2026

Germany: Six projections for the trade balance 2026 and 2021					
	Exports	Imports	Trade balance	GDP	Trade balance
2016	1441.7 bn	1202.6 bn	239.1 bn	3132.7 bn	7.6% of BDP
1999-2016, growth trends, % p.a.	5.74%	4.78%		2.48%	
	growth p.a.	growth p.a.	growth p.a.	growth p.a.	% of GDP
2026, 1st	5.74	4.78	9.6	3.0	14.25
2026, 2nd	5.74	4.78	9.6	4.0	12.9
2026, 3rd	5.74	5.74	5.74	3.0	9.9
2026, 4th	5.74	5.74	5.74	4.0	9.0
2026, 5th	5.74	6.64	-0.003	4.0	5.0
2021, 6th	4.0	6.0	-9.8	3.0	3.9

Growth of nominal exports and imports (incl. services), GDP and the trade balance in Germany 1991-2016			
Growth of nominal ..., % p.a.	1991-1999	1999-2016	1991-2016
exports	5.08	5.74	5.64
Imports	3.57	4.78	4.65
GDP	3.56	2.48	2.62
Trade balance, % of GDP	-1.7 (1999)	0.7 (1999)	7.6 (2016)

Potential stabilisers?

- appreciation of Euro against USD?
- Rise in oil and commodity prices?
- Demographic change, aging?
- Further outsourcing /re-location to Eastern Europe?
- Scarcer labour, rising wages → rising imports?
- Crises in deficit countries?
- China catching-up ?

???

Why is there a problem with surpluses, in particular with Germany's surplus?

- It has built-in mechanism to rise → explosive!
- Can split EMU/EU further in two blocs, cohesion of EU at risk
- France and Italy lose market shares against Germany, among others
- ¾ of net capital outflows is not FDI, mostly short term finance
- Risks of excessive inflows in deficit countries and „sudden stops“/reversal
- Export-led growth in DE led to low GDP growth 1999-2016, domestic demand dampened, export opportunity of partners narrowed
- Deficit countries forced to internal devaluation
- Exchange rate Euro/Dollar is misfit for one bloc or the other
- Monetary policy is unlikely to suit all
- But: little problems in good times, potentially disastrous in bad times
- Imbalances in currency union are different

Policy options

Guidelines

necessary: **continuous** strong rise in imports, not one-off level increase

- Increase policy awareness
- Long adjustment period: change from export-led to wage-led growth
- real internal revaluation → raise costs and prices (3% inflation, wage increase above golden rule) during adjustment period
- Increase GDP growth to 2%: expansionary fiscal policy for public investment, housing

Measures

- wage policy, inclusive wage increases for bottom wages, sector-wide overage of wage tariffs
- tax measures reducing excess corporate saving (retained profits); increase tax rate for property income
- change labour market policy that sustains precarious work contracts
- redistribution of income to bottom 1/3 of households
- structural change via innovation policies in France, Italy etc., stop deindustrialisation

- reducing fiscal protectionism (e.g. lignite mining)
- reforms the Macroeconomic Imbalance Procedure (MIP)

→ change tresholds from -4/+6 to -3/+3%. Private external deficits need caps if sustainable, similar to public debt.

→ change MIP indicators /thresholds to address surplus countries symmetrically

→ obligatory transfers for surplus countries to EU innovation fund in case of excessive surplus

Other measures:

- **Administrative measures:** tradable export permits , de facto variable fees for excess exports incl. quantitative export restriction (Stiglitz)? Only in mild form!
- **Capital flow management:** avoid huge short-term capital to EMU countries, surveillance, capital inflow controls in deficit countries?
- **Reform of EU MIP**

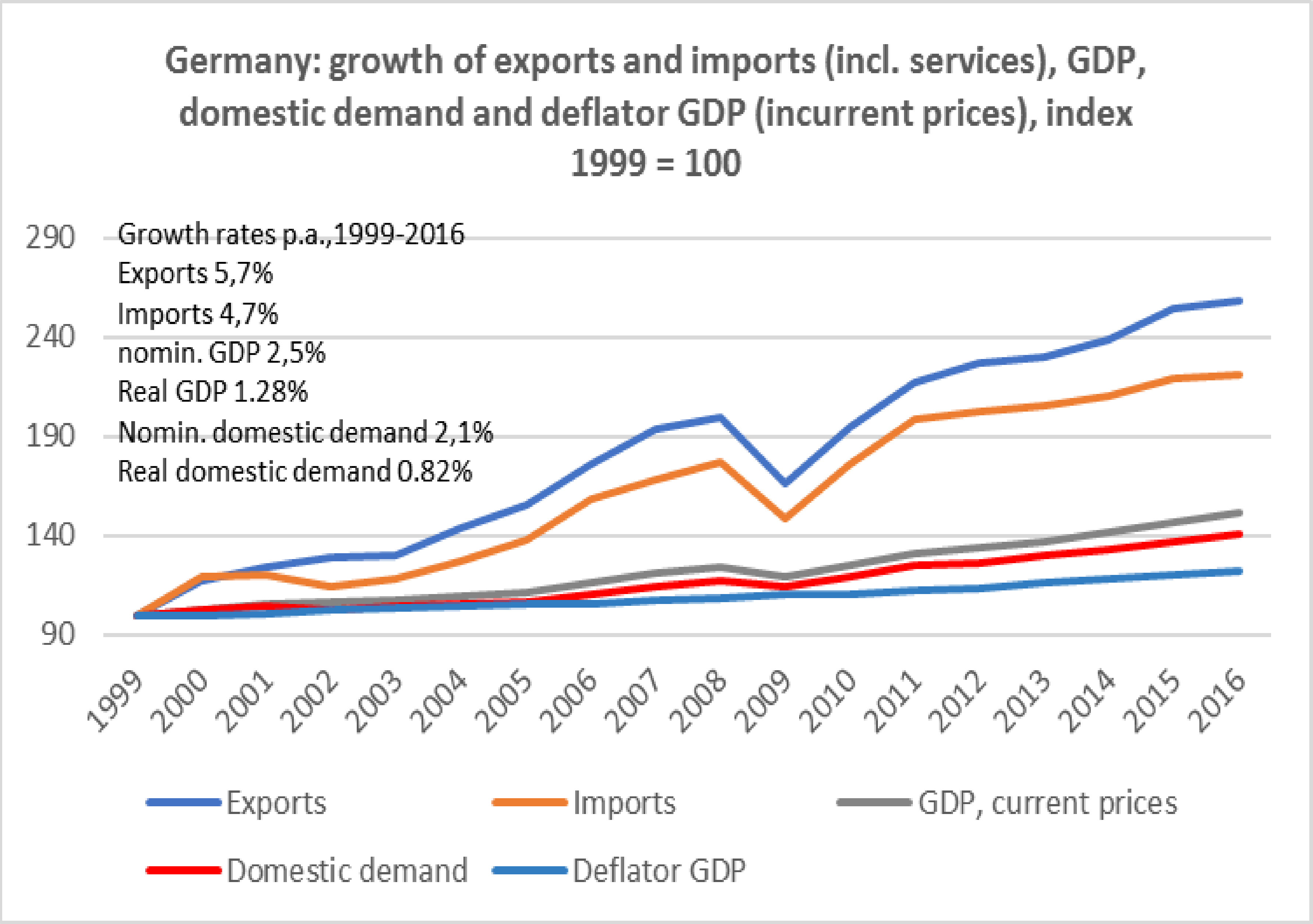
Reforms of MIP

- Thresholds for current account balances -4/+6% → -3/+3%,
- Cap for deviation from taverage of the rest 3 ppts → relative imbalance matters
- New upper threshold for NIIP → +35%
- Add inflation divergence indicator (1 ppt p.a. over 3 yrs)
- New ULC thresholds based on (medium term) golden rule for wages (+1% buffer)
- Surveillance of capital exports of surplus countries, capital inflow controls?
- Corrective measures in case of excessive imbalance: payment of **transfers** to deficit countries, earmarked for innovation
- Excessive surplus countries should be obliged to run higher budget deficits (exemption from SGP and Fiscal Compact), **no twin or triple surplus**
- Both intra and extra EMU imbalances should be reduced

Outlook

- Bottom line: package of measures; each one has small effects per year;
- Returning to 6% surplus would be great accomplishment in medium term; change decision making in EMU/EU that gives too much power to net creditor countries
- rebalancing via surplus countries takes long time once imbalances are high → change of structure of production necessary
- Key: create awareness in surplus countries about causes and potential remedies; putting surplus issue on the political radar in the self-interest of the country
- Is a long-term surplus sustainable? Yes, if debtors could pay debt service and when loans are rolled over ever and ever; this is more likely if debtors have higher growth.
- Measures taken will prevent further rise of surplus and contribute not very much to reduce surplus, simulations necessary

Appendix


Germany: growth of exports and imports (incl. services), GDP, domestic demand and deflator GDP (incurrent prices), index 1999 = 100
Growth rates p.a.,1999-2016
Exports 5,7%
Imports 4,7%
nomin. GDP 2,5%
Real GDP 1.28%
Nomin. domestic demand 2,1%
Real domestic demand 0.82%
290
240
190
140
90
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
Exports
Imports
GDP, current prices
Domestic demand
Deflator GDP