World Champion Capital Exporter

How rescue funds to southern Europe have financed the purchase of German goods.

BY HANS-WERNER SINN

These figures are sure to add fuel to the flames: according to the latest calculations by the Ifo Institute, Germany's current account surplus reached a new record in 2013, with €200 billion, equivalent to 7.3 percent of GDP. Germany will once again post the world's largest surplus.

Given that Germany's customers in southern Europe have dwindled, this development is quite astonishing. One can only wonder what's behind it. The economic collapse in southern Europe should have actually led to a reduction in the German surplus.

My explanation is as follows: The rescue funds flowed to southern Europe, were used by the latter to repay foreign debt, including debts held by third countries, and these third countries used some of the funds to increase their purchases of German goods. On top of that, the southern European countries have continued to import goods from Germany and the rest of the world, albeit not as much as in the past.

But what is actually the causal relationship between public capital exports and current account balances? The first thing is to realize the equivalence that exists between the overall capital flows, whether public or private, and the current account balance. Germany produces goods, and an income is generated in the amount of the value of such goods.

Hans-Werner Sinn is President of the Ifo Institute for Economic Research and Professor of Economics and Public Finance at the University of Munich.

THE INTERNATIONAL ECONOMY
THE MAGAZINE OF INTERNATIONAL ECONOMIC POLICY
220 I Street, N.E., Suite 200
Washington, D.C. 20002
Phone: 202-861-0791 • Fax: 202-861-0790
www.international-economy.com
editor@international-economy.com

The question of whether capital flows determine the current account balance or, conversely, the current account balance determines the capital account is moot, since both measure exactly the same process.

Income is an entitlement to goods. If Germans themselves exercise these entitlements through consumption and investment, that is, when in terms of value Germans absorb as much in goods as they produce, the current account is balanced. If they transfer such entitlements through lending their savings to residents of other countries or, put differently, if they export capital, by definition goods will also flow to those other countries. This gives rise to a current account surplus. The question of whether capital flows determine the current account balance or, conversely, the current account balance determines the capital account is moot, since both measure exactly the same process.

After the introduction of the euro Germany exported a large volume of savings and, therefore, on balance also goods, because investment opportunities abroad appeared to be much more attractive than domestic ones. Domestic net investment was for a while the lowest of all OECD countries. When the crisis hit and private investors became wary of exporting further savings, the European Central Bank pitched in. It underbid the capital markets in southern Europe with its refinancing credit and set policy parameters that prompted the German banks to repay the refinancing credit that they themselves had drawn from the Bundesbank, and even to start to lend their excess cash to the Bundesbank. Then, the ECB forced taxpayers through its OMT program to provide cover to savers in their acquisition of government bonds of the crisis-hit countries. Moreover, Germany has supplied part of the fiscal rescue credit provided by the community of nations. All these measures have implied a massive transfer of German savings abroad through public channels or with public protection, after the private transfer of capital collapsed. These facts are undeniable.

The credit support provided by the ECB and the community of nations is not reflected in a positive correlation between the German current account surplus and this public credit, since the public credit largely replaced the private capital. Furthermore, the private loans to southern countries, which are to some extent still being granted, have occurred partly thanks to the public insurance represented by the OMT.

The additional public credit provided to southern Europe has been used for two main purposes. For one thing, it helped finance the purchase of German goods which formerly had been financed with private capital imports. This does not mean that the number of goods sold this way increased, but that it shrank by less than otherwise would have been the case.

For another, the public replacement credit helped the southern countries to repay debts to third countries. The entitlement to goods that Germany relinquished by granting credit wandered from the crisis-hit countries to third countries, where it financed the purchase of German goods. Concretely, the euros used to repay debt put downward pressure on the euro in currency markets during the first years of the crisis; indeed, the value of the euro in dollar terms shrank by 13 percent from 2008 to 2012, and stayed at a level that was too low for Germany. The fact

All these measures have implied a massive transfer of German savings abroad through public channels or with public protection, after the private transfer of capital collapsed.

that over the past few years Germany's current account surplus *vis-à-vis* the crisis-stricken countries fell while it rose *vis-à-vis* the rest of the world results precisely from this process. This development may weaken in the near future, given that the capital markets have calmed down since 2013, depending on current account inertia. ◆