A different opinion

486. One member of the Council, **Peter Bofinger**, holds a different opinion of the German current account surplus analysis undertaken in this chapter.

487. In this chapter, the majority came to the conclusion that the high surplus in the German current account for some years now is not the result of a macroeconomic imbalance, but of weak domestic demand. Consequently, the majority does not see any great need to undertake steps in public investment to help reduce the current account surplus.

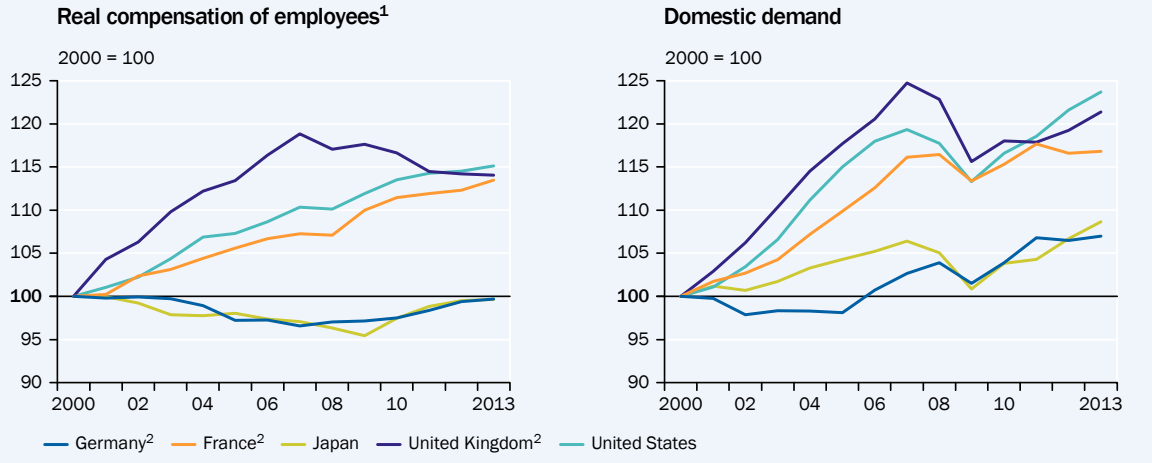
488. Overall, a marked weakness in demand has been noted in the German economy since the beginning of the last decade. This is closely related to the "**wage moderation**" undertaken in this period, which promoted German exports, but also resulted in very weak domestic demand development compared to the international level.

In the period from 2000 to 2013, the growth rate of **domestic consumption** of only 0.5% was significantly lower than the growth rate of GDP of 1.0%. In contrast, in the period from 1991 to 2000, the GDP growth rate and that of domestic consumption each registered 1.6%. This corresponds with an average rise in unit wage costs of 1.7% in the period 1991 to 2000, and of only an average 0.8% in the years 2000 to 2013.

The marked decline in German domestic demand can also be noted in a **comparison with other major national economies**. ↘ CHART 68 While in Germany and Japan real wages were nearly stagnant and domestic demand developed at only a very subdued pace, a considerable rise in real wages and domestic demand was evident in the US, the UK and France during the same period.

↘ CHART 68

Real wages and domestic demand in major economies



1 – Per employee deflated by the price development of private consumption expenditure. 2 – According to ESA 95.

Source: European Commission

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489. This does not contradict the argument that the German current account surplus is due to private sector **consolidation**. ↘ ITEM 423 ET SEQ. In fact, consolidation means nothing other than that German companies did not use their significantly higher profits – not least resulting from wage moderation – for additional investment, thereby spurring demand, but instead to reduce their debt. Contrary to wage moderation advocates' expectations (AER 2003 item 648), there is no guarantee at all that additional profit is regularly transformed by the capital markets into private or government demand.

490. It is no surprise that this development can be judged differently from a German point of view than a European one. The advantages of this strategy have outweighed the disadvantages on balance, as the negative effects on domestic demand were overcompensated by the sharp rise in exports. From the point of view of other countries, wage moderation and the current account surplus it has generated mean, however, a **deficit in aggregate demand.** At the same time, this results in a decrease in price competitiveness – which then requires wage moderation in those countries too. ↘ ITEM 140 ET SEQ. This overarching aspect, which is key to the European Commission's perspective, is ignored in the majority of analyses.

491. A very high current account surplus of a comparatively large national economy, which has actually been rising further in the past few quarters, is particularly problematic in a European and global environment, parts of which continue to be characterised by high negative output gaps. The **euro area's current account surplus that has increased** considerably in recent years shows, not least, the fact that the euro area adjustment necessary in the second half of the last decade due to the high current account imbalances occurred in an increasingly asymmetrical fashion. ↘ CHART 48, PAGE 219 This **asymmetry** is an important cause of the deflationary trends in the euro area.

492. Consequently, in view of a **risk of deflation for the euro area**, which the International Monetary Fund estimates at around 30% (IMF, 2014), the appeals by the European Commission and other international institutions to German economic policymakers are indeed justified. The economic development of the euro area, and also of the German economy, will approach stagnation in the coming quarters. The **European Central Bank (ECB)** has, for the most part, reached the limits of its room for manoeuvre, leaving aside the option of buying government bonds. The resulting pressure on what are already low German bond yields would cause great harm to German public acceptance of the ECB, which is dwindling anyway. As German economic policymakers have comparatively high fiscal flexibility, they should do everything they can to reduce the current account surplus through increased investment in Germany.

493. Lowering Germany's high current account surplus is not only in the interests of German partner countries but also in **Germany's own interests**. The very high German financial surplus and the unusually low ratio of net investment to national savings demonstrate that Germany is increasingly incapable and/or unwilling **to transform savings into material wealth**. ↘ CHART 54 LEFT The amount of net investment is thus not to be viewed in isolation but in the context

of total savings activity. With returns on financial assets that barely exceed the rate of inflation, allocating accumulated national assets, which are largely apportioned to financial assets, is far from ideal. The fact that foreign subsidiaries of Germany companies use a portion of statistically reported financial asset formation for investments has no strong bearing on the above revelation either. ↘ ITEM 426

494. In addition to more heavily promoting **private investment**, in particular via the reintroduction of degressive depreciation, a significant expansion of **public investment** a good option. This is not just about "investment gaps" that are identified in one way or another from the past but much more about the question of what Germany's **potential for future-oriented public spending** is. This question should be determined in the first place by how high government borrowing costs are and what returns can be expected from public spending. This is completely different in an environment of real interest rates close to zero than in one with significantly higher government borrowing costs.

A government investment initiative should not be limited to infrastructural expenses but should generally take into account **public spending that has a positive impact on growth and sustainability** (Thöne, 2004). Besides public investment, this also covers in particular spending in education, and research and development.

The federal government should thus create a "**future think tank**" in addition to the commission of experts, to bolster investments in Germany. This think tank should be given the mandate of determining the potential for this broad scope of **high-yielding public investment**. This is the only way to answer the question of what additional investments in Germany would make sense.

495. Empirical studies generally show that **public investment offers high returns.** Average long-term output elasticity of 0.05% to 0.06% was determined for transport infrastructure investments (Mello et al., 2013). An additional 1% investment in transport infrastructure generated additional long-term GDP growth of 0.05% to 0.06%. With a transport infrastructure total of €778 billion in 2011, an additional investment of €7.8 billion with an elasticity of 0.05% would therefore have yielded additional GDP of €1.35 billion. In other words, one billion in additional investment raises GDP by €173 million. Assuming a useful life of 30 years and straight-line depreciation of the effect on GDP, this results in a return of around 12%.

Very high returns can also be expected for government **investment in education**. Given attainment of upper secondary level education, the return rate for men is 9.4% and for women 10.9% (Buschle, 2013). The returns are particularly high if funds are used for early childhood education.

496. If German economic policymakers do not use this potential, it is not only disadvantageous to macroeconomic development in Germany and the euro area, but it also has negative medium and long-term effects on German prosperity.

The main argument against deficit spending is the **debt brake**. In applying this argument, however, it should be borne in mind that the ban it contains on deficit spending has **no economic basis**. In its expertise "Effectively Limiting Public Debt" published in 2007 (AER 2007 Item 2), the German Council of Economic Experts determined the following:

(...) demanding a general ban on public debt (...) would make as little economic sense as prohibiting private individuals or companies from borrowing.

Permanent public debt could, to a certain degree under intergenerational distribution aspects, be justified, namely in connection with public investment that increases the wealth of future generations or, via its productivity effects, bequeaths them future earnings, thus making them "wealthier". The intergenerational distribution effect of government debt in this case is a desirable result, in order to also have the future beneficiaries of today's spending share in the financing costs. This is the intention behind the "golden rule of fiscal policy" that permits deficit spending.

In line with this argumentation, the German Council of Economic Experts advocated at that time structuring the debt brake to enable **net investment to be financed through borrowing**.

497. As a reform of the debt brake is highly unlikely at the present time, use should at least be made of the **flexibility for government borrowing** inherent in this policy. The debt brake permits the federal government structural new borrowing of 0.35% of GDP annually, which is the equivalent of €10 billion. As no purpose is prescribed for this new debt, it could thus be used to finance additional expenditure for research and development, education and depreciation relief for private investments.

498. The unusually low yields on long-term bonds should however be a reason to thoroughly reconsider the debt brake again. **Low interest rates** only partially reflect the ECB's very expansionary monetary policy. It is due much more to a generally very marked **caution on the part of private borrowers**. This is notable in lending volumes of German banks, which despite such a low rate of interest are currently rising only slightly. For example, the rate of increase in mortgage loans in the 2nd quarter of 2014 stood at 2.0%.

"**Breaking even**" means that, as the largest potential borrower, the government assumes no more net debt. This makes the problem of a lack of borrowers prepared to take on long-term debt even worse. The consequences of a continued phase of low interest-rates for life insurance and private pension plans would be dire.

499. We do not share the opinion of the majority that the appeal of other member states to the German government to reduce the current account surplus contradicts to a certain extent the call to assist problem countries with rescue packages ↘ ITEM 473 ET SEQ. The rescue packages served primarily to ensure financing of **outstanding debt**. A lower German current account surplus through higher German imports would have meant additional current income for problem coun-

tries, which would have enabled them to finance the current expenses for their imports by borrowing less **additional funds**. Viewed in this manner, there is no contradiction at all between the rescue packages and a reduced current account surplus by means of higher German absorption.

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