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Current account imbalances: Possibilities for Trade Policy Action under the Auspices of the WTO – a German Perspective

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Abstract

Since 2011, Germany has consistently been the country posting the largest current account surpluses in the world. In recent years, this has led to a number of calls from economists and policy-makers in and outside Germany, and from international institutions and organisations, asking the Federal Government to take action to reduce the surplus. These calls have tended to focus on recommendations for action to strengthen private and public-sector investment and real wage growth in Germany. As current account imbalances have long become a global phenomenon, we would like to open a discussion on how this issue could be dealt with under multilateral trade policy.

JEL classification: F13, F32, F40

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1. INTRODUCTION

Germany is a country that has a strong tradition of posting positive current account balances (which are calculated by adding up a country's flows of goods and services, primary income, and secondary income between residents and non-residents). This has been the case except during the recessions in the late 1960s and the early 1980s and during the first few years following Germany's reunification – the latter being a time where a combination of a high demand for capital and strong domestic demand added up to a current account deficit. Since 2002, Germany has posted a current account surplus every single year (cf. figure 1). The average surplus posted between 2002 and 2010 was +4.6% of Germany's gross domestic product (GDP). Between 2011 and 2016, the figure rose to an average of 7.4% of GDP. Every year that has gone by since the entry into force of the European macroeconomic imbalance procedure (MIP), Germany's current account surplus has been higher than the relevant threshold (6% of GDP). The main reasons for this have been high savings rates and low net borrowing rates for private households, a rise in equity rates among companies in association with limited investments, fiscal consolidation, and a nominal devaluation of the euro.[1]

The paper is organized as follows. In Section 2, we provide a brief overview of the international debate on the German current account surplus. Section 3 outlines some stylized facts of the regional structure of Germany's current account surplus and the development of global current account imbalances. We present a multilateral trade policy approach under the auspices of the WTO in Section 4 and conclude in Section 5.

[1] German Council of Economic Experts: Mehr Vertrauen in Marktprozesse, Annual Report 2014/15, Wiesbaden 2014, 217.

Figure 1:
Germany's current account balance 1991-2016

Source: Own illustration based on Deutsche Bundesbank (2017)

II. THE INTERNATIOANAL DEBATE: GERMANY'S CURRENT ACCOUNT UNDER FIRE

Whilst current account imbalances are a global phenomenon, much of the criticism over the past few years has focused on Germany.[2] International institutions and organisations and some partner countries have argued that Germany's current account surplus represents a threat to macroeconomic stability, for the global economy, for the eurozone, and for Germany itself. In all of the macroeconomic imbalances procedures conducted since 2014, the European Commission has found that the scale and persistent nature of Germany's current

[2] Cf. K. Rogoff: Germany's current account surplus is a wider issue than it first appears, in: The Guardian, 10th April 2014; B. S. Bernanke: Germany's trade surplus is a problem, in: The Brookings Institution, 3rd April 2015, https://www.brookings.edu/blog/ben-bernanke/2015/04/03/germanys-trade-surplus-is-a-problem/ (30.11.2017); C. Jones: Germany's trade surplus sparks concern at home and abroad, in: Financial Times from 7th March 2015; J. Fox: Trump's Right: Germany's trade surplus is too big, in: Bloomberg View, 30th May 2017; The German problem: Why Germany's current-account surplus is bad for the world economy, in: The Economist, 8th July 2017.

account surplus represent macroeconomic imbalances. In this context, the Commission regularly recommends that Germany take action to stimulate domestic demand and harness the potential for growth that exists within its industry.[3] A similar line of argument has been used by the International Monetary Fund (IMF) and the Organisation for Economic Co-operation and Development (OECD).[4] In recent years, the U.S. Treasury has also repeatedly called upon Germany to deploy fiscal action to stimulate domestic demand. The latest request to this effect was made in October 2017.[5] U.S. President Donald Trump has also repeatedly criticised the German surplus, sometimes in rather blunt words.[6]

Within academia, however, assessments of the development of the global current account imbalances have been much less unequivocal. There are controversial debates not only about the definition of what constitutes a current account imbalance and what does not, but also about the underlying reasons for this phenomenon and whether corrective action is needed. There are many authors who also argue that the steep growth in global capital flows observed since the beginning of the 2000s represents a much greater threat to global development than any global current account imbalances.[7]

[3] Cf. European Commission: Alert Mechanism Report 2017 (prepared in accordance with Articles 3 and 4 of Regulations (EU) No. 176/2011 on the prevention and correction of macroeconomic imbalances), 16th November 2017, Brussels 2017.
[4] Cf. IMF: 2017 External Sector Report, Washington DC 2017; IMF: Germany – Staff Report for the Article IV Consultation, 2017; OECD Economic Outlook Germany, 2017.
[5] Cf. U.S. Department of the Treasury: Report to the Congress: Foreign Exchange Policies of Major Trading Partners of the United States, Washington DC, 17th October 2017.
[6] Vgl. K. Gilchrist: Trump reportedly calls Germans 'very bad,' threatens to end German car sales, in: CNBC, 26th May 2017.
[7] Cf. M. Obstfeld, K. Rogoff: Global imbalances and the financial crisis: Products of common causes, in: G. Reuven, M. Spiegel (ed.): Asia and the Global Financial Crisis, Federal Reserve Bank of San Francisco Asia Economic Policy Conference, 131-172; M. D. Chinn, J. Frieden: Lost Decades: The Making of America's Debt Crisis and the Long Recovery, New York 2011.

With regard to the implications of imbalances in foreign trade, most experts agree that countries that persistently post current account deficits and have high amounts of net external debt are likely to be more prone to crises.[8] There is probably no doubt that countries like Germany that post current account surpluses could also benefit from greater balance in their current accounts as this would mean that a greater share of the economic savings made as a result of the current account surplus would be invested the domestic stock of real capital, rather than being used to (further) expand the amount of money capital abroad. This will at least be the case where the profitability of the additional domestic investments is higher than that of Germany's foreign assets. In view of the fact that Germany's net external position reached a new record of EUR 1,709 billion (54% of GDP)[9] in 2016 and that investments in Germany[10] have been developing rather slowly in Germany over many years, the calls for an increase in public-sector investments and for greater incentives private-sector investment that have been voiced in the debate on the German current account surplus seem justifiable.[11]

However, there are various reasons why even higher levels of investments combined with other fiscal and economic-policy action of the type that is being demanded would not be enough to bring down the global current account imbalances in any substantial manner. First of all, some of the decisive factors for the German current account balance – which notably include demographic trends and the structure of the manufacturing sector, the net external position, the ECB's monetary policy, and world market prices for energy and raw materials – are beyond the control of the Federal Government. Secondly, the kind of stimulus required to deliver a noticeable reduction in the current account structure would be unjustifiably high,

[8] Cf. German Council of Economic Experts, I.c., 219.
[9] Cf. Central Bank of the Federal Republic of Germany (Deutsche Bundesbank): Zahlungsbilanzstatistik, September 2017.
[10] On the subject of private and public-sector investment in Germany since reunification, cf.:
B. Alm, M. Meurers: Wesentliche Fakten zur "Investitionsschwäche" in Deutschland, in: Wirtschaftsdienst, 95. (2015), 1, 24-31, https://archiv.wirtschaftsdienst.eu/jahr/2015/1/wesentliche-fakten-zur-investitionsschwaeche-in-deutschland/.
[11] Cf. B. Eichengreen: The German economy is unbalanced – but Trump has the wrong answer, in: Project Syndicate, 11th May 2017.

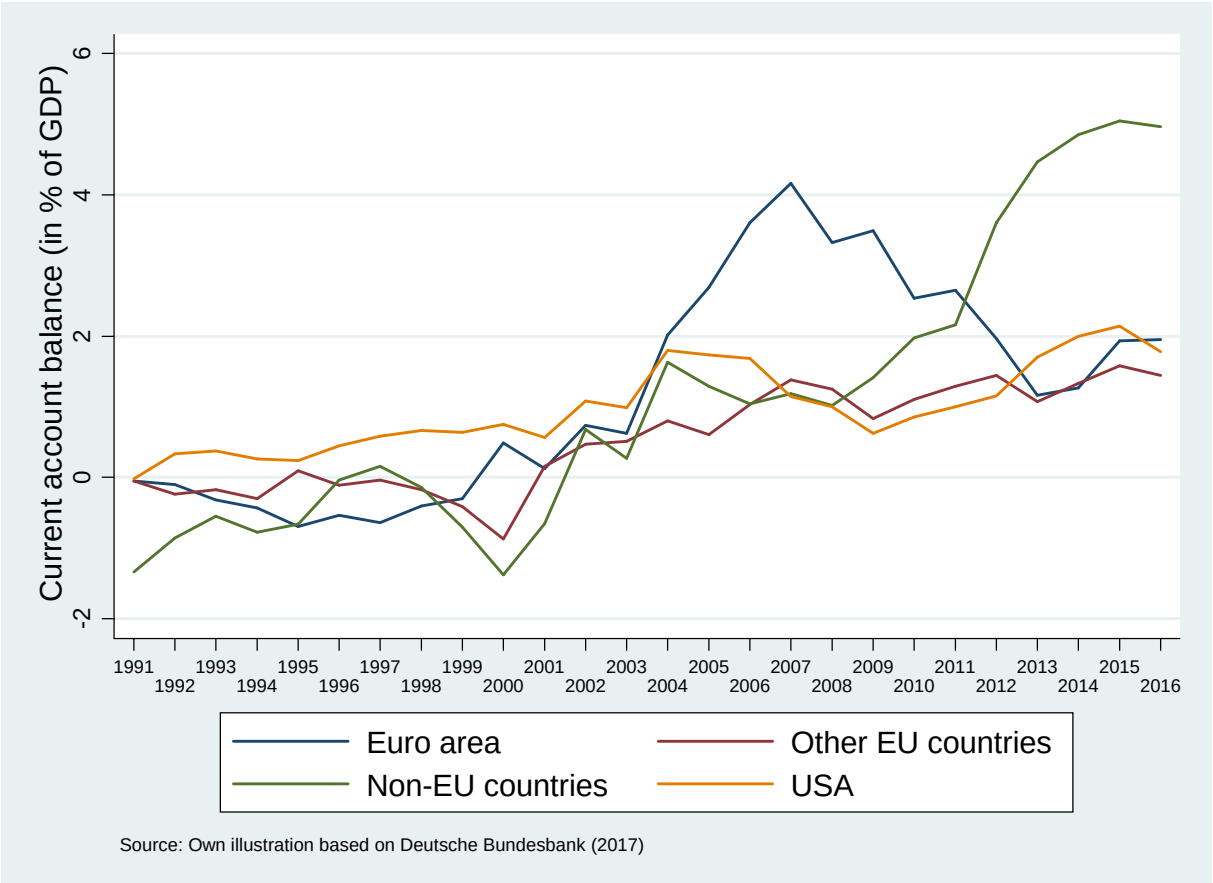
distortive, and perhaps even debt-financed.[12] Thirdly, even such a massive stimulus would have little effect in terms of rebalancing global imbalances, given that Germany's current account surplus, which is equivalent to approx. 8% of the country's GDP, accounts for much less than 0.5% of the global deficit in terms of GDP.

III. REGIONAL STRUCTURE OF GERMANY'S CURRENT ACCOUNT AND GLOBAL ACCOUNT IMBALANCES

Since 2002, the size of the German current account balance has changed considerably, as has its regional structure. Figure 2 shows that Germany's current account balance vis-à-vis other eurozone countries rose quite rapidly following the introduction of the single currency, to reach an all-time high of EUR 105 billion (4.2% of GDP) in 2007. With the onset of the global financial and economic crisis, Germany's current account positions have moved closer to those in the rest of the eurozone. Between 2007 and 2013, Germany's current account surplus vis-à-vis the other eurozone members fell by 70% as a proportion of GDP, to rise by a small margin in the years after that. Since 2012, the Germany's current account positions vis-à-vis the eurozone and the other EU Member States respectively have returned to being fairly similar in size.

[12] Cf. ifw Kiel: Wirtschafts-, Finanz- und Geldpolitik: Wirkungen auf die deutsche Leistungsbilanz, Endbericht für das Bundesministerium der Finanzen, 2017; C. Priesmeier: Lässt sich der deutsche Leistungsbilanzüberschuss mit vertretbarem Aufwand reduzieren?, in: Wirtschaftsdienst, 97. (2017), 9, 637-643.

Figure 2:
Regional composition of Germany's current account balance over time



Source: Own illustration based on Deutsche Bundesbank (2017)

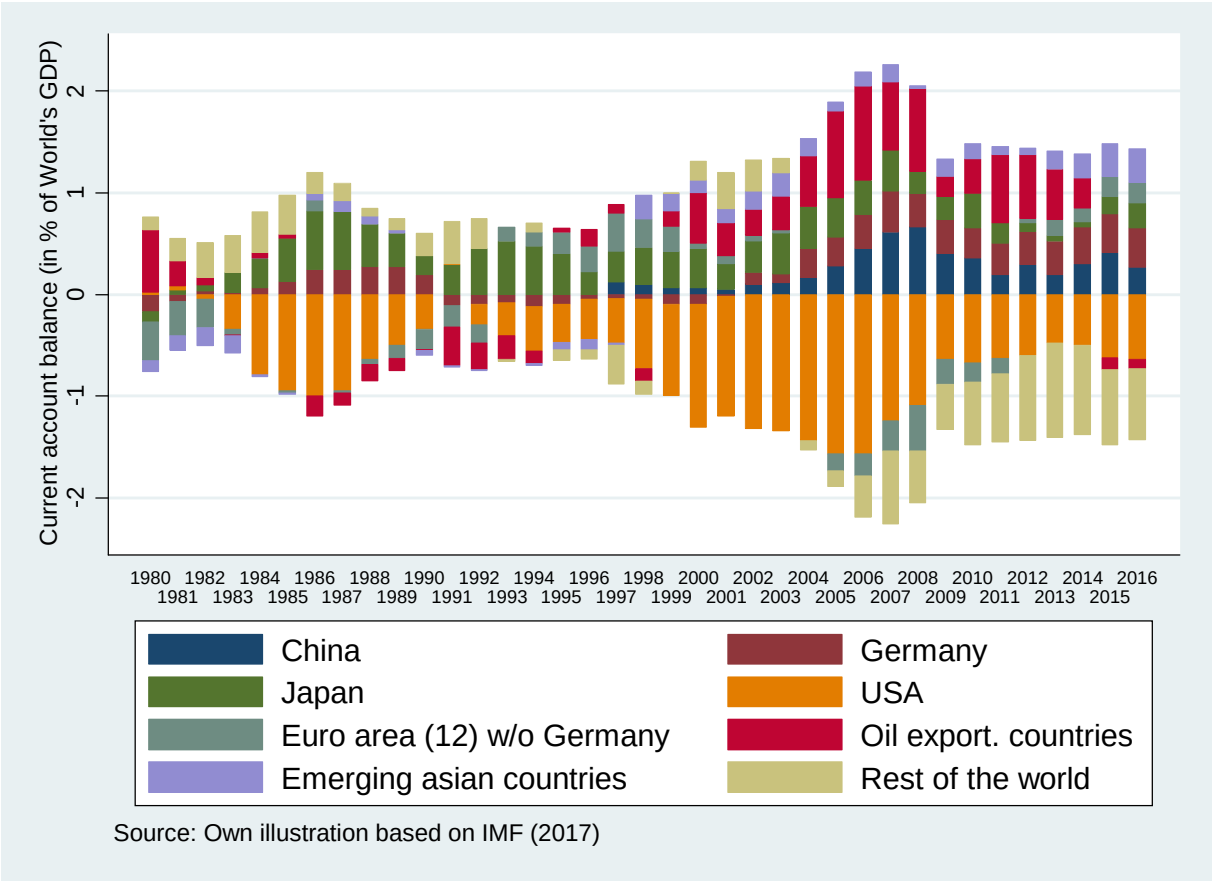
The growth in Germany's current account surplus seen in recent years has been due to a rise in Germany's current account positions vis-à-vis non-EU member countries. On average between 2011 and 2016, Germany's average current account surplus vis-à-vis states outside the EU was 4.2%, which is three times higher than the average for the 2002-2010 period (1.2%). This was not least due to the fact that the current account surplus vis-à-vis the U.S. rose dramatically between 2014 and 2016, to reach approx. 2% of GDP.

The scale of Germany's current account surpluses is striking, not only in terms of a historical comparison, but also at international level. The only country to have posted a larger current account imbalance (in this case a deficit) since the 1980 is the United States.[13] It is worth noting, though, that the U.S. current account deficit, after constantly growing for more than a decade starting in 1992, began to shrink quite considerably with the onset of the global

[13] With the exception of 1980, 1981, and 1991, when the U.S. posted a very small current account surplus.

financial and economic crisis and has been stable since 2009 (cf. figure 3). Similarly, China and Japan have not yet returned to pre-crisis levels where their current account surpluses are concerned. And, for the first time since 1998, the combined current account balance for the oil-exporting countries[14] was negative in 2015, on account of the drastic fall in commodity prices. Parallel to this, the 2016 current account balance for the eurozone except Germany[15] was at a record high whilst it still had been negative in 2008. Asia's emerging economies[16] (disregarding China and Japan) posted their highest ever current account surplus in 2016. All in all, the world's aggregated current account imbalances were not as high in 2016 as they were just prior to and at the beginning of the global financial and economic crisis, but still approximately twice as large as in the mid-1980s and mid-1990s.[17]

Figure 3:
Development of selected countries' current account balances

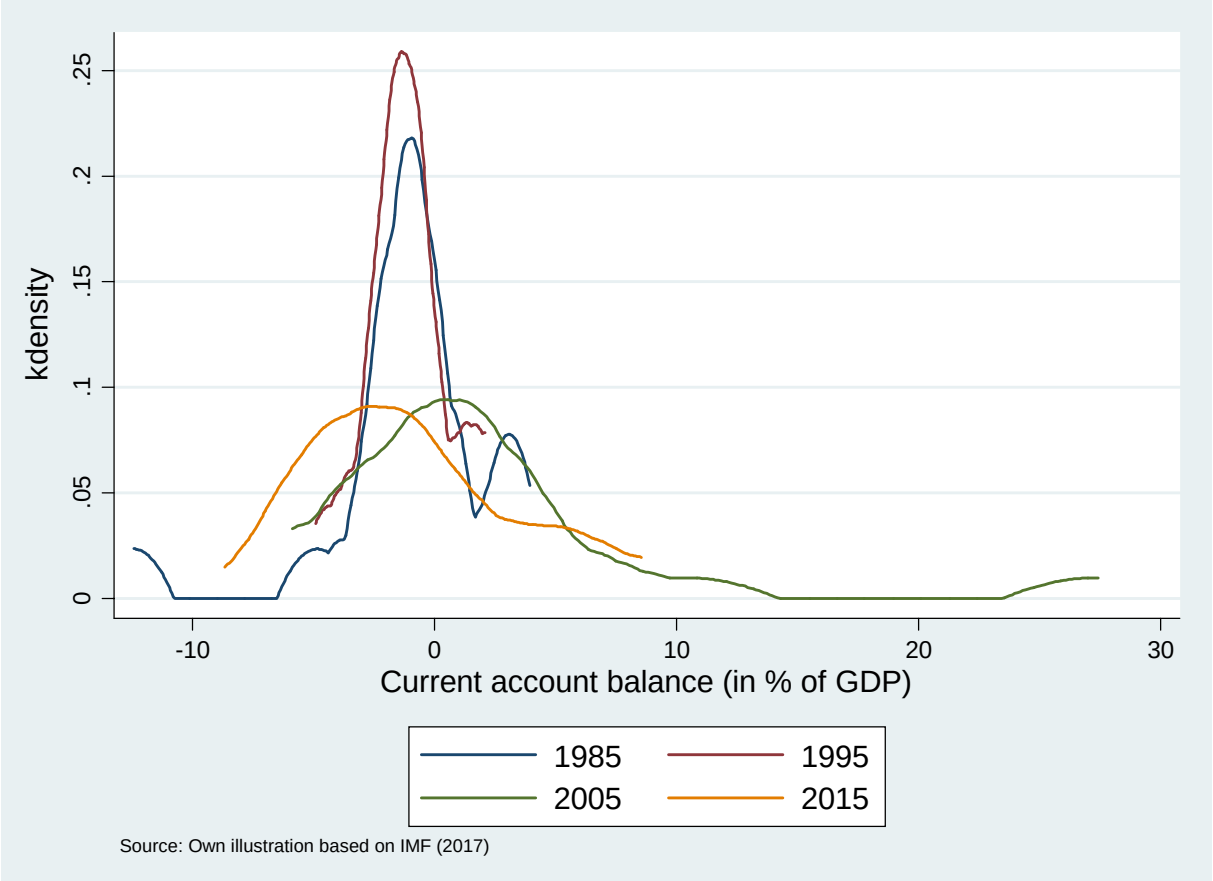


Source: Own illustration based on IMF (2017)

[14] Bahrain, Canada, Iran, Iraq, , Kuwait, Libya, Mexico, Nigeria, Norway, Oman, Russia, Saudi Arabia and Venezuela.
[15] Austria, Belgium, Finland, France, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal and Spain.
[16] India, Indonesia, Malaysia, the Philippines, Singapore, South Korea, Taiwan, Thailand and Viet Nam.
[17] For a detailed discussion of global current account imbalances and their development, cf. M. D. Chinn: The Once and Future Global Imbalances? Interpreting the Post-Crisis Record, Paper presented at the Jackson Hole conference, August 2017.

Current account imbalances within the G20 – a group that is aiming for sustainable and balanced global economic development – have also become much more pronounced in the course of the last and the current decades, compared to the figures for the mid-1980s and 1990s (cf. relative frequency of current account imbalances (figure 4)).

*Figure **4**:*
Current account balances within the G20



Source: Own illustration based on IMF (2017)

IV. MULTILATERAL APPROACH

Neither Germany nor any other economy is in a position to successfully tackle the challenge presented by global current account imbalances by taking action at national level. In contrast, trade-policy instruments could make a real difference. Whilst trade itself is never the reason for significant and persistent current account imbalances, it is the vehicle by which such imbalances spread to other states. By the same token, intergovernmental trade-policy coordination can be an effective means for addressing the underlying causes of these imbalances.

On account of its importance and its almost universal reach for effective coordination, the multilateral system would lend itself to this task much more than any bilateral or plurilateral trade agreements could. This kind of multilateral system could be established under the auspices of the WTO, which, as an institution under international law, could provide the right kind of institutional framework.[18] There are two reasons why the WTO would be ideally suited for this: Firstly, because it has 164 members (as of 2017) that account for 98% of the world's trade. Secondly, because – beyond its enormous reach when it comes to trade policy – the WTO is also tasked with encouraging greater coordination between its members' trade policies so as to address any imbalances between them. In this capacity, the WTO is also tasked with averting any systemic risks caused by a lack of policy coordination on measures to reduce current account imbalances.[19]

Marchetti, Ruta and Teh have outlined the role of the WTO when it comes to rebalancing global current accounts under its current mandate. In particular, they found that the WTO can serve its members as a forum for addressing imbalances and the causes underlying them by facilitating discussions on improved market access, on rule-making, and

[18] For the existing WTO instruments cf.: J. Marchetti, M. Ruta, R. Teh: Trade Imbalances and Multilateral Trade Cooperation, WTO Staff Working Paper, Geneva 2012.
[19] Cf. J. Marchetti, M. Ruta, R. Teh: Global Imbalances: What role for the WTO?, 2013, http://voxeu.org/article/global-imbalances-what-role-wto (10.11.2017).

by conducting dispute-settlement procedures.[20] In its activities, the WTO focuses on those imbalances that are caused by distortions resulting from the imposition of tariffs, non-tariff trade barriers and from subsidies. The WTO does not, however, explicitly address imbalances that are caused by differences in competitiveness etc. – despite the fact that the organisation is well-suited for this task and has a mandate for it.

There are also good political reasons why imbalances that are caused by decisions made as part of its members' trade policies and that risk undermining confidence in the multilateral trading system ought to become a focus for the WTO. The first of these reasons is the fact that the WTO is bound by the preamble to the WTO Agreement to safeguard the multilateral trading system. The second reason is that the shift that is underway in U.S. trade policy – and which is mainly based on the notion that imbalances result from inequitable trade practices – can be interpreted as a harbinger for greater protectionism, for instance taking the form of a re-negotiation of the North American Free Trade Agreement (NAFTA), the United States' withdrawal from the negotiations on a Transpacific Partnership (TPP), and a revival of the practice of conducting assessments into what are deemed inequitable trade practices and the possibility of imposing sanctions.[21] Other indications of a rise in protectionist instincts include the fact that the G20 Finance Ministers were at first unable to speak out against protectionism at their meeting in March 2017, that the WTO members were unable to reach significant agreements at the 11th WTO Ministerial Conference in Buenos Aires, and that there is a growing amount of outspoken criticism of the current account surpluses posted by some WTO members. In this context, WTO Secretary-General Roberto Azevêdo has

[20] Cf. for the analysis of existing instruments J. Marchetti, M. Ruta, R. Teh: Trade Imbalances and Multilateral Trade Cooperation, WTO Staff Working Paper, 2012, 17.

[21] In August 2017 the U.S. initiated investigations of China under Section 301 of the 1974 Trade Act, for potential trade-distorting dumping practices and lax practices when it comes to protecting intellectual property Cf. Office of the United States Trade Representative: USTR Announces Initiation of Section 301 Investigation of China, Press Release, Washington, August 2017, https://ustr.gov/about-us/policy-offices/press-office/press-releases/2017/august/ustr-announces-initiation-section (10.11.2017).

repeatedly warned of the dangers of reversing the liberalisation process, which, he said, might even result in trade wars being fought.[22]

This is why, the WTO ought to be used as a forum for deploying additional instruments to properly address the causes and impacts of future imbalances – beyond those tools that have been sketched out by Marchetti, Ruta and Teh. The Committee on Balance of Payments Restrictions, which is currently displaying little activity, is a body that can be used to address imbalances. Its main task, however, has been to grant members whose balances of payments are problematic a possibility to restrict imports in line with the 1994 GATT and with the General Agreement on Trade in Services (GATS), provided that certain criteria are met. The Committee is not tasked with addressing global imbalances – something that might be achieved by encouraging the relevant members to engage in coordinated reforms.[23] It would therefore be possible, in principle, to consider widening the mandate of the Committee on Balance of Payments Restrictions, thereby giving it greater weight.

The Trade Policy Review Body would lend itself for deepening members' cooperation on addressing imbalances.[24] This body, which operates on behalf of the WTO General Council, is tasked with conducting regular reviews of members' trade policies.[25] Even under the current system, the main task of the Trade Policy Review Body is to issue recommendations on trade policy, economic and fiscal policy, and on structural reform for the members reviewed by it.[26]

[22] Cf. a.o. A. Moreira: WTO chief urges Brazil to address competitiveness, in: Valor International, 18.8.2017.
[23] For information on the current work of the Committee on Balance of Payments Restrictions, cf.: WTO: Balance of Payments, https://www.wto.org/english/tratop_e/bop_e/bop_e.htm (10.11.2017). Ecuador was the last member to announce that it would introduce import restrictions due to problems with its current account balance.
[24] The Trade Policy Review was established in 1989, as an outcome of the Halftime Conference in Montreal that took place during the Uruguay Round.
[25] Cf. R. Senti: Welthandelsorganisation, Zürich 2000, 119.
[26] The reports of the WTO Secretariat are divided into the sections Economic Environment, Trade and investment regime, Trade policy and trade practices by measures and Trade policy by sectors.

It is true that discussion a member's role in global imbalances within the TPR would go beyond a mere review of its trade policy, but the mechanism underpinning the TPR already serves members as a basis for flexible and broad-based discussions and helps deliver transparency on trade policy. For instance, the mechanism allows members to submit questions related to trade policy to the member being reviewed. Members are also free to report on matters that are not directly linked to trade policy, such as the application of welfare standards. As of last year and following the 6th appraisal of the TPRM, all members have now been granted the right to regularly report on any developments in trade policy that they deem to be significant. Whilst efforts to widen the scope of the review (for instance to include e-commerce) have been unsuccessful, this recent change is still testimony to the high degree of flexibility that is inherent in the TPR mechanism.[27] Last year's Final Declaration by the G20 also provides for the WTO Secretariat to include points such as e-commerce in the report that is based on the TPR, and for members to report on these points on a voluntary basis.[28]

The flexibility of the TPR mechanism could be used to widen the scope of its work to include imbalances, for instance as part of the upcoming 7th appraisal of the TPRM.[29] The development of the current account balance has repeatedly been discussed in the TPR,[30] but only with regard to its implications for national economies. No recommendations have been made for multilateral coordination. Under the mechanism, individual members are reviewed every three, five or seven years, depending on their share on the global trade volume. In the interest of following an approach based on actual risks, it would make sense to apply the same rhythm to the analysis of current account imbalances.

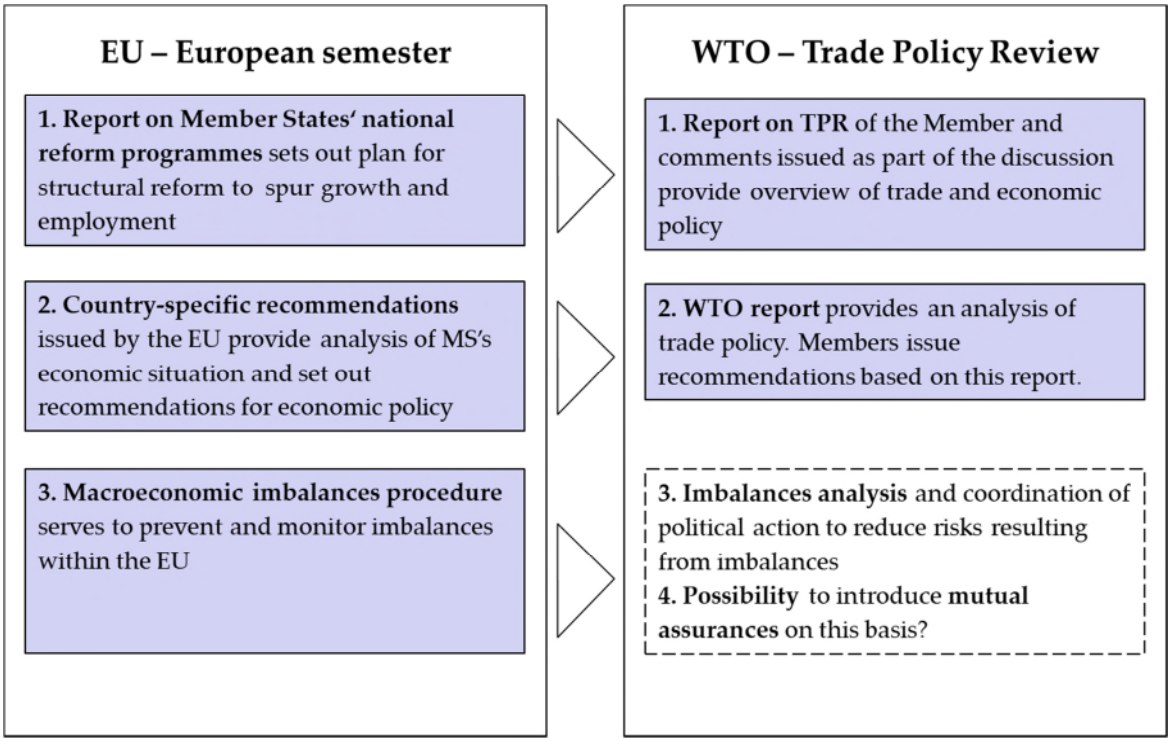
[27] Despite the rather broad-based discussion, it may well be the case that the 6th review will deliver no more than a consensus on procedural changes, such as an extension of the review cycles from two, four and six years to three, five and seven years.
[28] Cf. Final declaration of the G20-summit 2017, Hamburg, Annex 3.
[29] A decision to this effect could be taken by the General Council. Cf. Agreement establishing a World Trade Organization, Annex 3 TPRM in conjunction with Agreement establishing a World Trade Organization, Article X.
[30] Cf. WTO: Trade Policy Report China, Minutes of the Meeting, 2014, Chapter "2.1.2 Domestic economic situation", question 1. e.

Any adjustment made to the trade review mechanism to allow it to be used to address imbalances that are significant and persistent would have to aim to put in place a sound method for the WTO Secretariat to analyse imbalances and make tailored recommendations to its members. These recommendations could be for structural reform to allow members with a significant current account deficit to improve their competitiveness, or for action to deregulate the trade in services and to improve the investment climate in the case of those members that keep posting large surpluses. In line with the principle of reciprocal action, which underpins WTO law, countries with high deficits and others with high surpluses could mutually agree to engage in reform.

The analysis itself and the implementation of the recommendations could be designed to resemble comparable procedures that have proven to be successful. The EU, for instance, has the macroeconomic imbalances procedure conducted by the European Commission as part of the European Semester, the stability and growth pact, the fiscal pact, and the banking union. All these have been set up to monitor key factors determining member states' current account balances. The macroeconomic imbalances procedure, in particular, could serve as a blueprint for the next-generation TPR, as it is very similar in substance and serves to facilitate coordination between member states' economic policies. [31]The European Semester, complete with the reports on national reform programmes and the country-specific recommendations, much resembles the TPR mechanism, but goes further than this in that it also serves to monitor macroeconomic imbalances (cf. figure 5). The WTO Secretariat could use a scoreboard with various indicators showing imbalances to inform the discussions between its members.

Figure 5:
Comparing the EU European Semester to the WTO Trade Policy Review

[31] Cf. Geman Council of economic experts, I.c., 218.



Source: Own illustration

The European Semester also provides for a review as to whether recommendations have been implemented and even for the possibility of financial sanctions being imposed if this is not the case – something that is not part of the TPRM. However, the TPRB is successful precisely because the nature of the recommendations made under this mechanism is voluntary, which is why it would be unwise to put in place a mandatory system complete with sanction as has been suggested by Krueger[32] and others for the WTO. In the long term, the voluntary system allows for a more flexible and constructive procedure.

The framework could be designed to resemble the Article 4 consultations conducted by the International Monetary Fund (IMF). In accordance with these provisions, the IMF is tasked with monitoring the exchange rate policies of its members and with thereby overseeing the international monetary system and with guaranteeing its efficiency. For this purpose, the

[32] Potential measures that are being discussed include taxing new sovereign debt issued by countries with major current account imbalances, and financial sanctions tob e imposed on countries whose current account surpluses have reached dangerous levels. Cf. A. Krueger: Persistent Global Imbalances, in: S. Claessens, S. Evenett, B. Hoekman (ed.): Rebalancing the Global Economy: A Primer for Policymaking, London 2010, 185-190.

IMF has a mechanism that flags up dangerous developments and calls for economic policy action to counteract these. In their current form, the Article 4 consultations conducted by the IMF are more visible than the TPR, which lends them greater weight.

Unlike the TPR, both the European Semester and the Article 4 consultations are conceived to prevent dangerous developments rather than counteract them. It is true that the TPR also looks at current and upcoming policy action. For the most part, however, it adopts a retrospective view and covers the period since the last review. The next-generation TPR ought to help flag up impending risks resulting from current account imbalances at an early stage.

V. CONCLUDING REMARKS

For the first time in four years, the German current account surplus is likely to decline in absolute terms in 2017 and 2018. Over the long term, it is also likely to continue to fall as Germany's population ages. Nevertheless, it is likely to continue to remain at a very high level (compared to earlier times as well as to the situation in other countries) in the medium term, which will give rise to further discussions at international level.

Current account imbalances are not a German phenomenon alone, but occur all over the world. Knowing that there is a risk that any persistent major global current account imbalances may trigger a (fresh) rise in protectionism and hence international welfare losses, it would seem to make sense to broaden the debate about national economic and fiscal policy (which would be necessary even if there were no imbalances) to include multilateral approaches to tackling persistent and major current account deficits/surpluses.

In the future, the WTO (alongside other institutions) could play an important role in this as part of its coordinating function where trade policy is concerned. This would require the WTO to extend its activities to specifically include policies that have an impact on global

current account imbalances. One way of achieving this could be to expand the TPR mechanism. Given the high degree of flexibility when it comes to trade policy reviews, all that would be required would be for some of the “large” WTO members to agree to make current account imbalances one of the points that are discussed under the TPRB. In other words, this issue could be dealt with in practice under the TPRB without even the need for any changes to the WTO framework. This is a move that would make it possible for the WTO not only to illustrate its relevance and its ability to act (something that is increasingly called into question especially in the light of the 11th Ministerial Conference in December 2017), but also to successfully support national and international trade policy action at multilateral level.

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