Burkhard Balz: Germany and America - (economically) stronger together

Speech by Mr Burkhard Balz, Member of the Executive Board of the Deutsche Bundesbank, at the Thanksgiving Dinner of the AmCham, Chapter Lower Saxony, Hannover, 22 November 2018.

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1 Welcome

Ladies and gentlemen,

Mr Barsch,

It is a pleasure to be here today to talk about something I very firmly believe in, as reflected by the title I have given my speech:

Germany and America – stronger together: stronger in economic terms, and in more ways besides.

I am particularly happy to be talking about this particular topic because I know that the American Chamber of Commerce in Germany generally sees things as I do.

So I can pretty much lead on from what was said at your New Year's Reception back in 2004, which some of you might have attended nearly 15 years ago. The speaker back then was Professor Werner Weidenfeld who, previous to that, had been the Federal Government's coordinator for German-US relations, a post he occupied for more than ten years [between 1987 and 1999]. In his address to the AmCham in 2004, Professor Weidenfeld remarked that Europe and the United States need a calculated partnership strategy. America needs partners in leadership. And Europe is essentially the natural partner.

My impression is that the partnership between the United States and Germany is in need of care and attention right now.

Your decision to invite me, a representative from the Bundesbank, to speak on this topic today is particularly fitting. That is because the Bundesbank has been nurturing major transatlantic relations from day one.

2 The Bundesbank's transatlantic relations

To be precise, the very creation of the Deutsche Bundesbank – or should I say, that of its predecessor, the Bank Deutscher Länder – is very much tied up with an American, and British, project: the currency reform in 1948.

The Allies deemed this reform necessary in order to combat the steady depreciation of the German currency. To put the project into practice, it was also necessary to create the right German institutions.

But the Americans' support didn't end there. Would you believe that the first Deutsche Mark banknotes were designed and printed in the United States?

Take a look at one of these original Deutsche Mark notes and you will quickly see the signature style of the responsible Bureau of Engraving and Printing and the similarity to US dollar notes.

So the Bundesbank – and its predecessor, the Bank deutscher Länder – enjoy close and amicable relations with the Federal Reserve System that go back a long way.

For one thing, there is the quasi-institutionalised cooperation at the international level which came into being when the Deutsche Mark was pegged to the US dollar as part of the Bretton Woods monetary system.

Nowadays, the Federal Reserve and the Bundesbank meet at regular intervals to share their views, such as within the G 20 framework or at the Bank for International Settlements in Basel.

And for another thing, the Bundesbank has been a fixture at the New York financial centre since back in 1963, and it has had its own representative office there since 1986.

You see, the United States and the New York financial centre were becoming increasingly important for the Bundesbank's operations. We do, after all, hold a great deal of our reserve assets in US dollars.

Our team of employees in New York observe and analyse the US financial system and capitalise on their network of public and private institutions, particularly their link with the Federal Reserve System.

Our team's first-hand assessments help the Bundesbank to evaluate the state of the global economy. And I dare say that developments which might jeopardise financial stability can be identified sooner at close proximity than from afar.

Incidentally, this intense exchange of views and ideas is not a one-way street. The team at the New York Bundesbank representative office also report on economic developments in Germany and the euro area. Plus, they explain the Bundesbank's views on matters of monetary and economic policy. Their expertise in this capacity was particularly sought after in the midst of the European sovereign debt crisis.

The more interconnected our world becomes, the more important it is to engage in an intensive exchange of facts and opinions. This is why I firmly believe that nurturing objective and constructive dialogue – in a way that covers as many relationships in society as possible – is of crucial importance these days.

You, the stakeholders of the American Chamber of Commerce in Germany, have been contributing to this worthy goal for more than a century now.

This evening it is my turn to make a contribution to this dialogue, and I expect that my speech will be followed by stimulating debate over the course of the evening.

I will use some figures in my speech to illustrate the economic relations between the United States and Germany and shine a light on various aspects of the protectionism debate which should not, under any circumstances, be allowed to drive a wedge between our two countries. And in closing, I will also touch upon the challenges facing the United States and Germany alike. But let me begin with an account of the economic situation on both sides of the Atlantic.

3 Economic activity

Both Germany and the United States have been enjoying one of the longest periods of expansion in post-war history. The upswing that kicked off in 2009 is as intact as ever, despite what the less-than-unanimously-positive economic reports for Germany in recent months might suggest.

Various institutions are in the process of revising their growth forecasts downwards for a number of countries, many of them reportedly spooked by the spectre of uncertainty raised by the trade conflicts.

The Bundesbank recently dedicated an article in its October Monthly Report to examining the macroeconomic effects of uncertainty in greater detail and came to the following conclusion.

- While it is true that uncertainty noticeably depressed economic activity during the global financial crisis ten years ago,
- there is no evidence that it has been dampening growth in the more recent past. So the relationship between uncertainty and the real economy is not as clear, or as close, as is often supposed.
- This view is supported by the fact that global activity was not affected by the Brexit referendum or by various political developments in Europe and the United States.

The current IMF staff projections expect the global economy to expand just as strongly in 2018 and 2019 as it did last year.

It’s striking to note that the IMF staff left their projections for the current year unchanged for the United States and China in particular – the protagonists in the trade conflict. I find that hard to reconcile with the theory that major uncertainty effects are at play.

Projections were instead downgraded significantly for a number of emerging market economies in particular on account of country-specific vulnerabilities. These weak spots are becoming increasingly telling, because as the United States normalises its monetary policy stance, the emerging market economies as a whole are finding it more and more difficult to attract investors. However, at present, there is no question of a looming large-scale emerging markets crisis.

The IMF staff are expecting activity in Germany, and in the euro area, too, to expand by around 2 per cent this year and next, and are forecasting an even stronger rate of growth for the United States.

Joblessness in Germany has fallen to its lowest level since reunification and to its lowest point in nearly 50 years in America. At the same time, employment levels are continuing to increase, and it looks like wage growth is picking up speed. Skilled labour is becoming increasingly hard to find.

It's hardly surprising, then, that capacity constraints are on the rise. Germany’s economy has been outpacing its potential growth rate for five straight years now.

Fiscal policy will probably stimulate growth further – and this stimulus is already making itself felt in the United States.

The tax cuts and spending increases pushed through by the US administration effectively represent a major economic stimulus package. A model-based analysis by the Bundesbank indicates that the tax reform alone will probably add substantially to the pace of US economic growth this year and next.[1] However, this expansionary fiscal policy stance will also tend to widen the current account deficit.

But before I look in greater detail at what is currently the widely debated topic of current account positions on both sides of the Atlantic, there are a few facts about German-US economic relations I would like to share with you.

4 Close economic relations

There’s no doubt about it – the trade ties spanning the Atlantic Ocean are significant.

The United States was Germany’s number one trading partner in 2017 – not just for goods exports, but for services exports and imports as well. Only when it comes to goods imports does the United States rank fourth among Germany's main trading partners.

In the other direction, Germany is a major partner for America, but not quite such a crucial one. Naturally, that’s down to the size differences between the two economies.

Germany ranks sixth for US exports of both goods and services. Based on its share of US goods imports, Germany comes in as America's fifth most important major trading partner, though it does garner a respectable silver medal for imports of US services, behind the United Kingdom.

Some of the transatlantic trade flows are intracompany transactions that take place within multinational enterprises. And there are some cases where companies cater for a market by producing within that market instead of exporting goods or services. So foreign direct investment, or FDI, is another component of German-US economic relations.

Roughly 8 per cent of FDI in Germany comes from the United States. In the other direction, German foreign direct investment as a share of total FDI in the United States likewise comes to approximately 8 per cent. Measured as a percentage of total German FDI, the United States account for a substantial 15 per cent.

When we view the economic ties between the United States and Germany from both angles, we can see just how close, and how important, the economic relations between the two countries are. Conclusions are more difficult to reach when economic relations between the two countries are expressed in terms of bilateral trade and current account balances, for example.

5 Bilateral balances reveal little

Ladies and gentlemen,

If the United States posts an overall deficit in its trade balance while Germany generally posts a surplus, we expect to see this reflected in bilateral trade as well.

A Bundesbank study shows that the deficit in the United States' bilateral trade in goods correlates to the overall trade balance of its partner countries. The greater the overall balance of the partner country, the greater the US bilateral deficit. The balance of German-US trade in goods does not deviate noticeably from this empirical regularity.[2]

Having said that, bilateral balances generally are not very meaningful because they disregard relations with third countries. Many US enterprises, for instance, have chosen to do business from the Netherlands as a way to cover the European market.

Thus, it makes sense to consider the EU as a whole as a partner of the United States. Trade expert Gabriel Felbermayr rightly pointed out that the United States actually has a current account surplus with the EU: income from services and primary income more than compensate for the trade in goods deficit.

And ultimately, current account balances are the result of all savings and investment decisions in an economy. A distortion of the market or competition cannot be directly identified from these balances. What's more, current account balances can only by steered by policy to a limited extent.

And the notion of reducing Germany's current account surplus so as to deplete the US deficit is unfeasible simply on the basis of size. The US economy is over five times as large as the German economy.

In addition, increased demand in Germany would have knock-on effects on other trading partners. Greater demand for imports in Germany would primarily benefit our neighbours, such as Austria, the Czech Republic, the Netherlands and Poland.[3]

To reduce the US current account deficit, it would make more sense to influence savings and investment decisions in the United States. As I've already indicated, a good starting point would be a change of direction in US fiscal policy, shifting away from its expansionary track.

Indeed, simulation exercises conducted by the Bundesbank reveal that the tax cuts passed in the United States will probably push up government debt and the current account deficit considerably.[4]

6 The danger of protectionism

I would like to warn against thinking of tariffs as a cure for the current account deficit. By introducing new tariffs, the United States is actually running the risk of putting its own economy, not least, on a worse footing.[5]

This is because tariffs don't just lead to lower imports; exports are also likely to take a hit due to depressed income in customer countries and appreciation of the dollar.

What's more, tariffs can increase domestic inflation and thus reduce the purchasing power of households. Taken together, these factors threaten to damage the economy in question.

Increased inflationary pressures would also lead to higher interest rates. For a debtor country like the United States, though, this means higher interest payments to other countries. Factoring in lower exports, the result is that the desired improvement in the current account balance may not materialise.

And when partner countries retaliate with their own measures, at the very latest, there will clearly be welfare losses for everyone involved. World trade and global economic activity will be impaired. In 2017, the Bundesbank published macroeconomic model-based analyses showing that there can only be losers in trade wars.

This brings me to the heart of the protectionism debate. It may seem easy to point the finger in this discussion.

Germany is quite rightly determined in calling for free trade in goods. And restrictions on capital flows are something that is difficult to reconcile with this.

But Gabriel Felbermayr also points out that the EU is by no means a free trade paradise, especially compared with the United States.[6]

For 48 per cent of all products, the EU imposes a higher tariff than the United States, while the reverse is true for 30 per cent of products.

It is a welcome development that the two sides are now discussing how to dismantle trade barriers. Lowering tariffs would boost welfare and benefit consumers, in particular.

For example, a study carried out by the European Commission shows that EU consumers have saved €60 billion a year since the 1990s as a result of tariff reductions. Nowadays, thanks to the conclusion of a free trade agreement, purchasing a car from Korea with an import value of €13,300 is tariff-free, but a 10% import tariff that was previously in place would have resulted in additional costs amounting to €1,300.[7]

It's also encouraging to see that the United States, Mexico and Canada have agreed on an updated free trade agreement.

But the most important thing here is to preserve the rule-based multilateral trading system overall.

This also means that existing rules have to be upheld. Unfair trading practices such as dumping in the steel industry cannot be tolerated.

The rules also have to be enhanced. Many parties are now pushing for better protection of intellectual property rights.

Just recently, 13 partners – among them the EU – signed a communiqué with the intention of reforming the World Trade Organization and making it more sustainable.

On the whole, it seems to me that the threat of an all-encompassing global trade war has diminished, if anything, of late.

Having said that, the measures already adopted in the trade dispute between the United States and China are certainly likely to have macroeconomic repercussions. It is chiefly the two main players that can expect to sustain losses.

According to model-based analyses performed by the Bundesbank, economic output could be ½ per cent lower in both the United States and China over the medium term compared with potential developments in the absence of the trade dispute.

Other economies would also tend to be harmed, albeit to a lesser extent.

The euro area and Germany would suffer only a little. But nor should Germany assume that it will benefit from the spat while remaining unscathed itself.

In total, the punitive tariffs are likely to dampen global trade by just under 1 per cent after a certain interval.

7 Challenges of globalisation and technological advances

From an economic perspective, it’s clear that free trade gives a long-term boost to general prosperity.

Yet a shift is under way in employment prospects and also relative wages. Globalisation has its winners and losers.

Studies show, for instance, that China’s integration into the global economy, in particular, led to notable job losses in manufacturing in the United States. More new jobs were probably created – but in other sectors and often in completely different locations. Local labour markets seem to have adapted only slowly, and the lifetime income of workers who lost their jobs declined considerably.[8]

For Germany, on the other hand, globalisation created major opportunities to export to eastern Europe and China.[9] In this way, it helped Germany to retain manufacturing jobs – although this is also in net terms.

Equally, technological progress has its winners and losers as well. The OECD estimates that nearly one in ten occupations could be automatable over the next few years.[10]

Politicians have a responsibility to create the conditions needed for new, future-proof jobs. People who are affected by globalisation or, for example, by digitalisation also have to be capable of recognising and taking advantage of opportunities in a changing environment.

Education is the key to this. In a recent interview, Nobel Prize winner Robert Shiller pointed out that the United States has been lagging behind for some years now. In Germany, too, the business community has bemoaned the insufficient credentials of many young job applicants.

But education cannot just be confined to the first third of a person’s life. Rather, learning should be a lifelong process. For employers, this basically means that they need to facilitate access to professional training and development for their staff.

And at the same time, a targeted tax and transfer system should be designed to cushion social hardships.

8 Conclusion

Ladies and gentlemen,

The United States, Germany and also Europe are facing very similar challenges.

The persistent economic upswing is giving policymakers greater opportunities to actively shape these challenges – just as it lies in their hands to preserve and strengthen free trade and the rule-based multilateral trading system.

I've already indicated that I currently see no reason to believe the situation will escalate into a full-blown trade war – and that's not chiefly the optimist in me speaking, but the analyst. The particular interests of the countries involved should prevail.

In the long term, after all, protectionism leads to a dead end. Open, competitive markets, on the other hand, boost productivity and prosperity. They allow everyone to do what they are best at and also ensure that innovation spreads quickly.

Today, let's use Thanksgiving as a chance to be thankful that poverty has decreased and prosperity increased worldwide over the past few decades – the result of competitive, open markets.

At the same time, we have to set out the tasks that currently have to be faced, of which there are many. One such important task is to maintain transatlantic links, preserving the partnership between the United States and Europe – and Germany.

On that note, I'd like to thank you for inviting me here today.

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1 See Deutsche Bundesbank, The potential macroeconomic impact of US tax reform, Monthly Report, February 2018, pp. 14–16.

2 See Deutsche Bundesbank, The magnitude of the United States' bilateral trade balances, Monthly Report, July 2017, p. 87 f.

3 See Deutsche Bundesbank, The international spillover effects of an expansion of public investment in Germany, Monthly Report, August 2016, pp 13–17.

4 See Deutsche Bundesbank, The potential macroeconomic impact of US tax reform, Monthly Report, February 2018, pp. 14–16.

5 See Deutsche Bundesbank, The danger posed to the global economy by protectionist tendencies, Monthly Report, July 2017, pp. 77–91.

6 See G. Felbermayr (2018), Zölle im transatlantischen Handel: Worauf, wie viel und wie gerecht?, ifo Schnelldienst 6/2018. >

7 See L. Cernat, D. Gerard, O. Guinea and L. Isella (2018), Consumer benefits from EU trade liberalisation: How much did we save since the Uruguay Round?, European Commission, DG Trade, Chief Economist Note, No 1.

8 See D. H. Autor, D. Dorn and G. H. Hanson (2016), The China Shock: Learning from Labour-Market Adjustment to Large Changes in Trade, Annual Review of Economics, Vol. 8, pp. 205–240.

9 See W. Dauth, S. Findeisen and J. Südekum (2017), Trade and Manufacturing Jobs in Germany, American Economic Review: Papers & Proceedings 2017, Vol. 107, pp. 337–342.

10 M. Arntz, T. Gregory and U. Zierahn (2016), The Risk of Automation for Jobs in OECD Countries: A Comparative Analysis, OECD Social, Employment and Migration Working Papers, No 189, OECD Publishing.