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Current Account Surplus, Economic Growth, and a Political Double Bind – The Case of Germany

Puzzling Political Debates

Germany is on the dock, big time. In its 2013 'Alert Mechanism Report' the European Commission announced that Germany jointly with Luxembourg would have to undergo a thorough review of its potentially disturbing high current account surplus. The procedure is a legal necessity given that over the last three years Germany's surplus has been above the critical level of 6% of its GDP, and the Commission indicates in its analysis that it even may stay for a while at its current ratio of close to 7%. The Commission's alert was preceded by a stern warning in the report to the US-Congress on international exchange rates in regards to the potentially deflationary impact of Germany's current account surpluses.[1] Yet the messages are not unidirectional. Only a few days after the Commission's alert its own DG 'Economic and Financial Affairs' published a downward revision of the growth projection for the Eurozone, mainly due to the fact that the German export sector experienced a slack in its growth dynamic, which then reflected in a downward projection of overall German GDP-growth. Only three days later the EU Commission published its opinion of the draft budgetary plan for 2014 of the German government where it stated that overall the draft plan is in compliance with the rules of the Stability and Growth Pact but that it would need a new analysis that takes the budget of the newly formed coalition government into account.

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[1] "Germany has maintained a large current account surplus throughout the euro area financial crisis, and in 2012, Germany's nominal current account surplus was larger than that of China. Germany's anemic pace of domestic demand growth and dependence on exports have hampered rebalancing at a time when many other euro-area countries have been under severe pressure to curb demand and compress imports in order to promote adjustment. The net result has been a deflationary bias for the euro area, as well as for the world economy. Stronger domestic demand growth in surplus European economies, particularly in Germany, would help to facilitate a durable rebalancing of imbalances in the euro area. The EU's annual Macroeconomic Imbalances Procedure, developed as part of the EU's increased focus on surveillance, should help signal building external and internal imbalances; however, the procedure remains somewhat asymmetric and does not give sufficient attention to countries with large and sustained external surpluses like Germany. "

All this sounds a bit odd. At the one side, Germany is getting blamed to beggar its Eurozone neighbors with its export strength and on the other side already a slight reduction in Germany's export dynamic makes the Commission shiver that such a slide could drive the whole Eurozone closer towards its fragile crisis zone. More over, given that a surplus in the current account represents a surplus of domestic savings over investment it is quite a conundrum that budget-wise Germany should potentially turn more frugal. More public savings, ceteris paribus, would increase the surplus in the current account. The more the German government sticks to its Eurozone crisis approach, the less domestic growth and the more exports are to be expected. Thus, rather then aiming to constrain Germany's current account directly, one could argue, Germany should move towards an expansive fiscal policy, even by risking to violate the Stability and Growth Pact (SGP). This seems to be the policy advice of the US. Letting the relatively large fiscal space of Germany untapped - so the argument - only results in further export pressures. However, such a policy recommendation conflicts with the austerity philosophy put in place by the European Commission under the guidance of - Germany. Still, given the nature of the problem a violation of the SGP by Germany would be rational economic policy but for sure it would make bad public policy. This seems to be reason enough for the new government to stick to its guns. Rather then going for a bold growth project that would lift the domestic sources of economic growth on a new plateau the German political-economic class tends to stick to its export model[2]. What are the implications of such a policy? I will, first, recall the 'imbalance'; debate of the last couple of years. I a second step, I will present empirical data that show that Germany's surplus in the current account has undergone serious changes since 2010. In third step I discuss a policy proposal that could be a elegant way out of the conundrum.

The Reappearance of the Ghost

During the first half of the 2000s the polarization of national current accounts and in particular the large deficit of the US has given cause to concerns. Rather optimistic views about the sustainability of this global constellation met equally dark scenarios that hinted to an enormous crisis potential (Mann 2002). The Great Recession of 2008 seemed to have confirmed the darker perspective. However, this understanding opf the roots of the crisis soon was moved into the background as other explanations for the financial crisis became more prominent. Though scholars and politicians alike were accepting that global imbalances might provide a problem the dominating view was now that the polarization of current accounts was only one problem besides others of more importance. Over time, those other factors became more and more dominant in the

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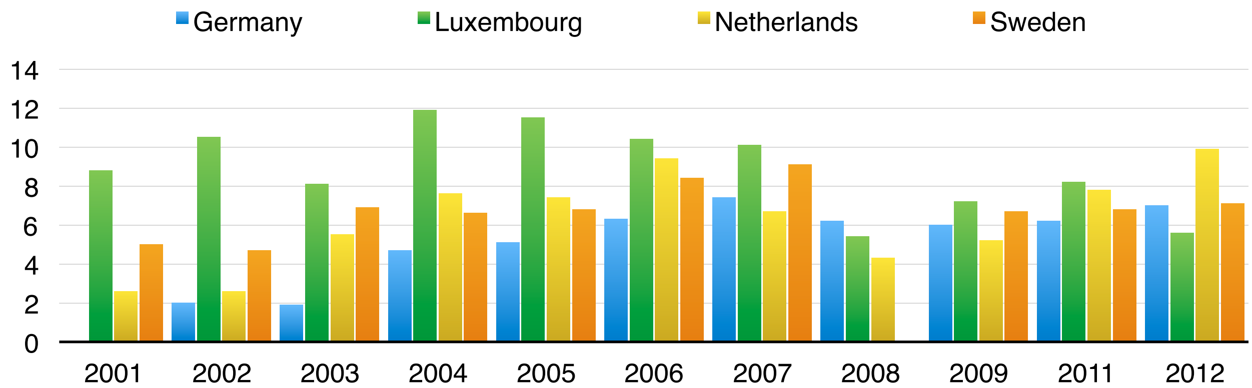
[2] In February 2014, the state secretary for Europe in the German Foreign Ministry, Michael Roth, declared that Germany should adhere to its critics and make efforts to shrink the trade balance surplus. This seems to me, though, a outsider view that will not become politically relevant; at lest the official budget of the new coalition government gives no signal for such a policy-turnaround.

policy debates, and today it seemed widely shared that the crises and the lack in growth dynamics is rooted in overstretched governments who firstly need to drastically reduce their economic footprint by moving towards public budget surpluses.



Graph 1 The Surplus Group: Current Account in % of GDP

S*ource: Eurostat*

From a purely analytical point of view one could anyway argue that the current account position of an economy, negative and also positive, may have repercussions for the global economy but that this does not hold for a construct like the European monetary union. In a monetary union, the argument goes, national current accounts are nothing else then regional current accounts for the overall union that are denominated in the same currency. Eventually, any regional surplus or deficit will be settled due to the working capital and labor mobility within the currency union. Surpluses and deficits in the same currency may cause political attention but are not posing economic problems. Exactly this view dominated in regards to the build-up of the current account polarization where academics and politicians alike played down the economic relevance of the surplus and deficit positions. Given the relatively low level of labor mobility it was mainly up to capital markets to deal with any serious disequilibrium, assisted by the rules of the SGP. This *duo infernale,* however, did not work very well.

Of course, the financing of current account deficits is not automatically as harmonious as it appears on paper. When the Great Recession hit, financial markets more and more became suspicious of the large deficits of the Southern Periphery of the Eurozone, and started to ask for risk premiums in exchange for steady capital flows. After the ‘Greece disaster' the virus started spreading. Particularly Spain and Portugal were now seen as endangered by a loss in international price competitiveness that was reflected in long-term current account deficits. Out of sudden the polarization of current accounts inside the Eurozone became a hotly debated topic, and a severe economic problem due to 'sudden stops' and drastic downgrading of the credibility of national economies. The abrupt ending of the lending boom ('sudden stop') not only posed severe problems for the financing of the current account deficits but more so put enormous pressure on the financial institutions of the receiving economies as their balance sheets became more and more untenable. Still, the dominant economic policy discourse stressed public deficits and debt levels as the main crisis-inducing factors, and it was mainly the German government at the time that pushed for a austerity agenda. Only at the margin a debate was started that hinted to the role of Germany and other surplus economies in the build-up of the polarization of current accounts.

The escalating sovereign debt crises of European economies forced some quite substantial changes in the form of economic governance but it was only in 2010 that the EU Commission introduced its Macroeconomic Imbalances Procedure (MIP) that also included the criterion of current account[3] as one of the indicators national governments should look at.

Initially, the debate about current accounts in the Eurozone focused only on deficit economies. Deficits, so the interpretation, indicate that those economies 'live' above their own economic potential, and thus the recommendation to move back into the economic spaces of feasibility. MIP also defined a too high surplus as an imbalance that needs correction but this indicator did not play any relevant role in the debates. The situation changed in 2013 when to the dismay of the German government the ghost wandered to the small group of surplus economies (see graph 1). Germany was not the only culprit, though. If we exclude Luxembourg for the reason of being an international finance hub that recycles vast volumes of capital flows, we can see that Netherlands and Sweden (as a non-Euro economy) even showed relative higher surpluses then Germany in most of the years between 2001 and 2012. The political as well as the economic weight of Germany turned all the attention to Germany, though.

Why should a structural surplus of the current account be a reason for concerns? A surplus in the trade balance and then in the current account signals an excess of national production over actual national spending in terms of consumption and investment, i.e. surplus economies 'import' demand from outside. For deficit economies the opposite holds, i.e. such economies 'live beyond their means', and finance this lifestyle by borrowing abroad. In a situation where global demand is high *and* the financial markets act sober, such an imbalance poses no direct problem. Deficit

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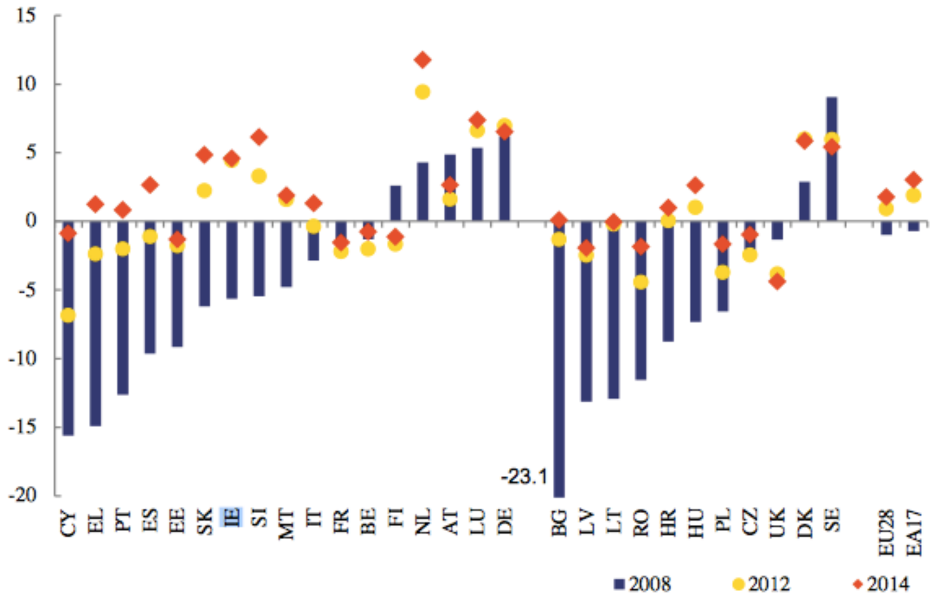
[3] The current account, though, was introduced asymmetrically, namely as 3 year backward moving average of the current account balance as percent of GDP, with a thresholds of +6% and -4%.

economies channel the inflowing financial resources into efficient activities that generates in the next round additional income that then allows for a smooth-working debt service. Financial market actors supervise the risk allocation and make sure, in their own interest, that the financial flows are used appropriately. In case of a monetary union the critical *transfer problem* that was already so thoroughly analyzed by Keynes (1929), does no longer exist because all transactions are in one and the same currency. This disappearance, though, does not implicate that deficits and accompanying net capital inflows may not pose problems. Problems occur when (i) financial markets are getting nervous and redirect their net flows, (ii) the net inflows were not used appropriately and thus don't generate adequate income flows to successfully deal with the 'budget problem', and (iii) interest rate conditions change quickly to the worst. All three conditions came into being in the aftermath of the Great Recession.

The net international investment position measures the financial assets and liabilities position of a country towards the rest of the world. Graph 2 depicts those positions for 2008, 2012 and in a forward-looking way for 2014. The imbalances are obvious. A small number of economies with positive net investment positions go hand in hand with a larger number of economies that show negative net international investment positions. Most critical deficits are to be found in the Eastern part of Europe but - as it is well known in the meantime - also in the Southern periphery. This only reflects the distribution of current account surpluses and deficits. As a share in GDP Germany's net investment position ranks third but in absolute terms the position is huge and was an enormously relevant source of financing current account deficits.

Graph 2 Net International Investment Positions as % in GDP, 2008, 2012 and 2014



Source: Eurostat, Commission services.

Already until 2008, and thus even before the Great Recession hit, the net investment position of EU-economies, driven mainly by activities of the financial industry[4], was rather uneasy. A substantial number of EU-economies and in particular economies of the Eurozone showed negative investment position towards the rest of the world, and a few economies were on the positive side. The underlying *credit bonanza* was not least fed by the rapid convergence of nominal interest rates of Eurozone economies due to the omission of risk premia that followed the launch of the Euro. Financial markets treated public bonds and private liabilities of, say Greece, in the same way then German or Dutch counterparts. Capital was available in abundance, and thus cheap. On the side of the surplus economies was the need to recycle the surpluses, not least due to a relative lack in dynamics of domestic investment, public as well as private, and private consumption. Exactly this channeling of resources from surplus to deficit economies created the ground for the troubles to come. Financial markets failed twice to deal with the imbalances.

The high and persistent current account surplus of Germany, to stick to the case, necessarily comes with capital exports. Cumulative net financial outflows from Germany

[4] Until 2008 net capital exports were mainly driven by activities of the financial sector. See:http://www.bundesbank.de/Navigation/EN/Statistics/External_sector/External_position_of_banks/Tables/tabellen.html

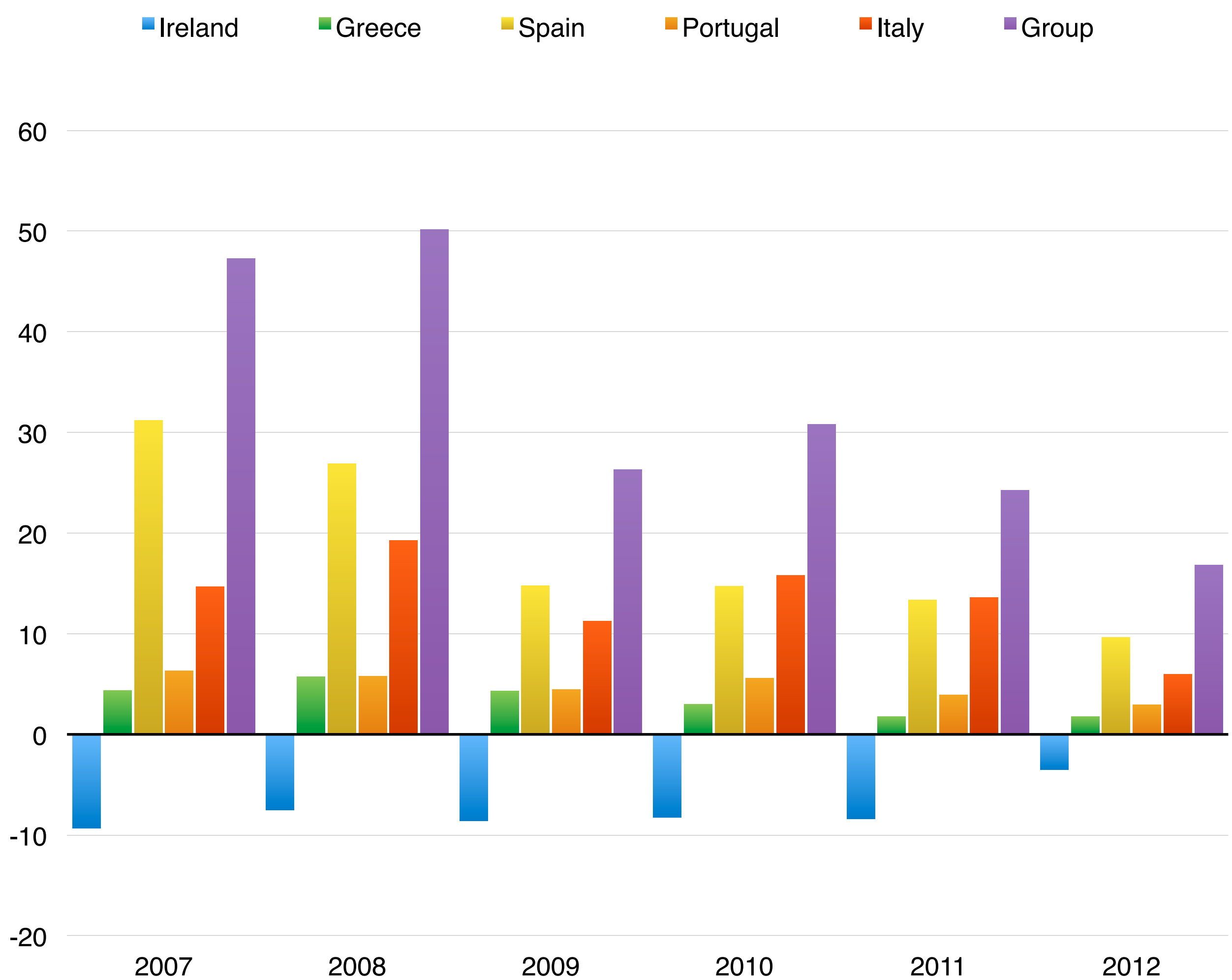
during the period 2003-2007 amounted to 45.9% of GDP[5]. Since 2008, this flow has steadily dried out, and private flows have been substituted by official flows, mainly via the German TARGET 2 claims (see Chen/Milesi-Ferretti/Tressel 2013). It has been mentioned before that German capital export until 2008 were a critical source for the build-up of speculative bubbles in a number of Eurozone economies. Those capital flows went mainly to private actors in the absorbing economies. Capital flows after the outbreak of the Greek crisis were a different beast as the backflow of private funds now was compensated by credit flows via political mechanisms. Latter came with harsh austerity policies that triggered demand-led crises, which consequently reduced the import demand of those economies and thus improved the trade balances. Imbalances in the Eurozone are not gone but they have become overall much smaller compared to the build-up period of the crises. This has implications for the surplus economies.

Where is the Surplus Coming From?

A long-term surplus of the current account of an economy signals that one or more of the regular adjustment mechanisms are not working properly. In a regular case adjustment is being achieved by changes in the exchange rate, i.e. an appreciation of the currency of the surplus economy, respectively a depreciation of the currency of the deficit economy. An appreciation would undermine the price competitiveness of exports and would make imports relatively cheaper. Cheaper imports increase the domestic competition pressure and may lead to downward pressure of costs of production. As a result, the trade balance surplus and then the current account surplus would get reduced or even eliminated. A malfunctioning of adjustment mechanisms can have several reasons that range from market distortions to politically motivated exchange rate interventions. In a monetary union the exchange rate mechanism is no longer available. Without the Euro the German currency (Deutschmark, for the sake of the argument) would have shown a strong appreciation and German exports would have adjusted accordingly. With the Deutschmark gone such a correction was not happening. In other words, the high and increasing current account surpluses of Germany were decoupled from the exchange rate of the Euro. The same principle holds for all deficit economies of the currency union: In the absence of an external devaluation adjustment of the current account deficit became the job of internal devaluation. Internal devaluation differs from external devaluation by, among others, its asymmetrical status. Rather then inducing changes in the surplus economy it ask for adjustments in the deficit economies. Even more important, this adjustment mechanism works foremost through the aggregated income channel rather then through the price channel. Unlike external devaluation the mechanism of internal devaluation is of strict political character as those adjustments arte not market-driven but rely on political interference. The politically created reduction

[5] The share of non-financial corporations was 24.8 % of GDP and the share of financial corporations was 4.7 %; private households had a share of 27.8%. It should be noted that most of the overall flow eventually is being managed by financial institutions.

in aggregated income should then in a second round result in a compression of imports and also improve exports due to price competitiveness effects.



Graph 3 Germany's Current Account Surplus Partners

In other words, due to the lack of an external devaluation mechanism it is up to economic policies to kick-start an internal devaluation that eventually will create a downward pressure on wages. Such a mechanism is by far not as elegant as the exchange rate mechanism, and actually generated quite substantial political uproar in the crises economies. Moreover, the mechanism is economically as well as politically asymmetric in its very nature because both do not occur in the surplus economy but are contained to the deficit economy.

Critics of the German export model argue until 2010 or so, that Germany's competitiveness position would have a 'beggar-thy-neighbor'-effect on its Eurozone partners. There is no doubt that the periphery had serious deficits with Germany until the outbreak of the sovereign debt crises. Graph 3 shows that Greece, Spain, as well as Italy were running deficits. It is still under debate how exactly the divergence in competitiveness should be best understood. The dominant view suggests that Germany controlled its unit wage costs in superior ways, whereas the deficit economies during the

Graph 4 Germany's Main Surplus Trade Partners, 2012, bn Euro

period experienced a strong increase of unit wage costs. The result was a widening cost gap that provided the ground for German's success. Contrary to this mainstream view, I argue that the German superiority is less caused by the far-reaching labor and welfare state reforms (Hübner 2014; Dustmann et al 2014) then it is by differentials in inflation rate, the accommodating nominal wage policies of trade unions, and in particular by the build-up of EU-wider value chains that put enormous pressure on wages in the German industry (Hübner 2014).

Whatever the reasons for Germany's competitive advantages are, it is obvious that the trade surpluses with other Eurozone economies came with implications – for the surplus as well as for the deficit economies. In the case of Germany, as I will argue below, the price is a substantial growth underperformance. In the case of deficit economies it is the adjustment crises those economies had to undergo.

The constellation has changed (see graph 3). Germany's current account surp[uses with the southern periphery of the Eurozone have become significantly smaller. This change has not been caused by adjustments on the side of Germany but is due to the successful working of internal devaluation in the deficit economies. As graph 3 shows, Germany's surplus with Greece, Spain, Portugal and Italy drastically decreased since the onset of the sovereign debt crises. This is no surprise at all and only reflects the brutal destruction of effective demand due to the austerity policies those economies had to launch in order to get support from the newly established EU rescue funds.

Despite these processes of adjustment Germany's overall current account surplus stood high and continued to increase. Now the source of the surplus stems more and more from outside the Eurozone (see graph 4). In 2012 its trade balance surplus amounted to 5.7% of GDP; the current account surplus showed a surplus of 6.3% of GDP (BMWT 2013). Even though Germany's main trading partners were still in Europe (69% of German exports stay inside Europe, and 70% of its imports stem from European economies), this economic area is getting less important in regards to the origin of Germany's trade balance surplus. If we look at the geographic distribution of Germany's surplus in the trade balance (goods and services) we can see that the southern periphery actually plays no longer any important role as ‘overshooting’ entities. The share of Italy, Spain, Greece in Germany’s overall trade surplus adds just up to less then 10 %. In 2012 Germany was even running a deficit with Ireland. Close to two third of the overall trade surplus of Germany in 2012 is made up by France, US, UK and Austria. In other words, the contribution of the periphery to Germany’s surplus is close to negligible.

Aggregate data confirm the impression that the Eurozone share in Germany’s trade balance surplus is decreasing, and so is the share of German exports to Eurozone economies (BMWT 2013). However, it is also true that close to two-third of the German surplus is with EU-27[6], i.e. the EU’s role for German surpluses may have diminished but it is still its main source of origin. Data from 2012 indicate, though, that Germany’s overall external trade has become relatively diversified. In absolute terms the US and China rank in regards to exports No 2 and 4; and in imports 3 and 2. More disaggregated data show also that only Germany was benefitting greatly from the strong Chinese import demand for investment goods and high-end consumer goods but also that Chinese exports crowded out substantial segments of previous export markets of southern Eurozone economies (Chen/Milesi-Ferretti/Tressel 2013).

The sources of the trade balance as well as current account surpluses of Germany changed significantly over the last couple of years. Unlike other economies, Germany successfully compensated for the loss in markets due to the Eurozone crises by extending its reach to growth poles in the global economy. Given the deeply entrenched austerity mechanisms in the Eurozone it is likely that this change will continue. Germany will stay being a export model but a model that will be much more global in its scope and range as it used to be.

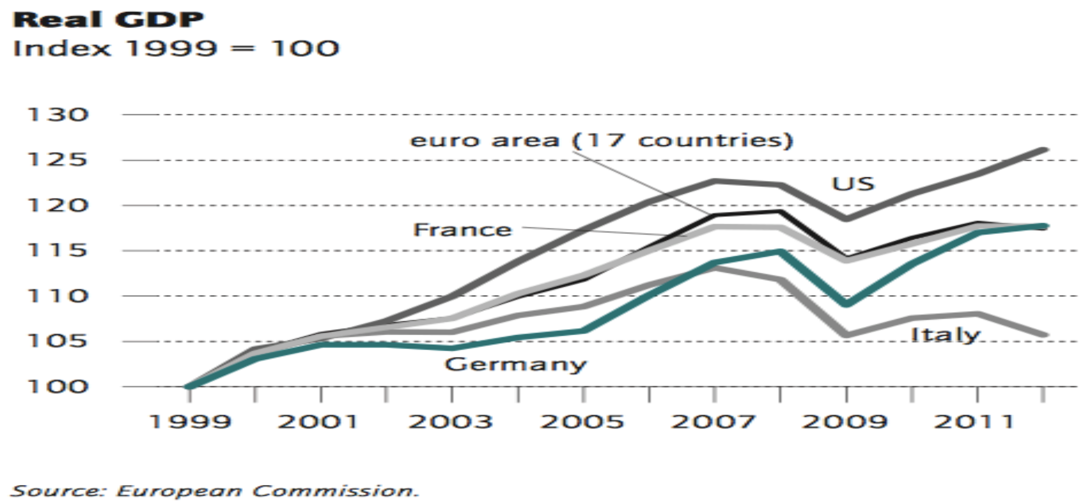
Inferior Growth and Superior Exports: A Modest Proposal to Overcome the Impasse

Despite its current reputation as an economic powerhouse in Europe empirical facts suggest otherwise. Rather then representing a coherent growth model, Germany is the rare case of a growth model that succeeds despite its flaws. The success is grounded in its well-oiled export machinery that drives the overall economy but simultaneously results in a imbalanced growth structure. Germany’s real GDP just grew by an annual average of one percent between 2000 and 2013 – not a rate that usually qualifies an economy to be a powerhouse. It is true, though, that this average camouflages relevant developments, in particular the relative strong recovery after the disastrous shrinking of its real GDP in 2009 by more then 5 percent. More over, the recovery has been speedier as in many other OECD-economies. Between 2010 and 2013 Germany’s real GDP went up by overall 9.3-percentage point, only followed by Canada with 9.1.percentage points and the US with 8.7 percentage points. France only grew in this

[6] The share of Eurozone economies in the German surplus represents 36.7% in 2012.

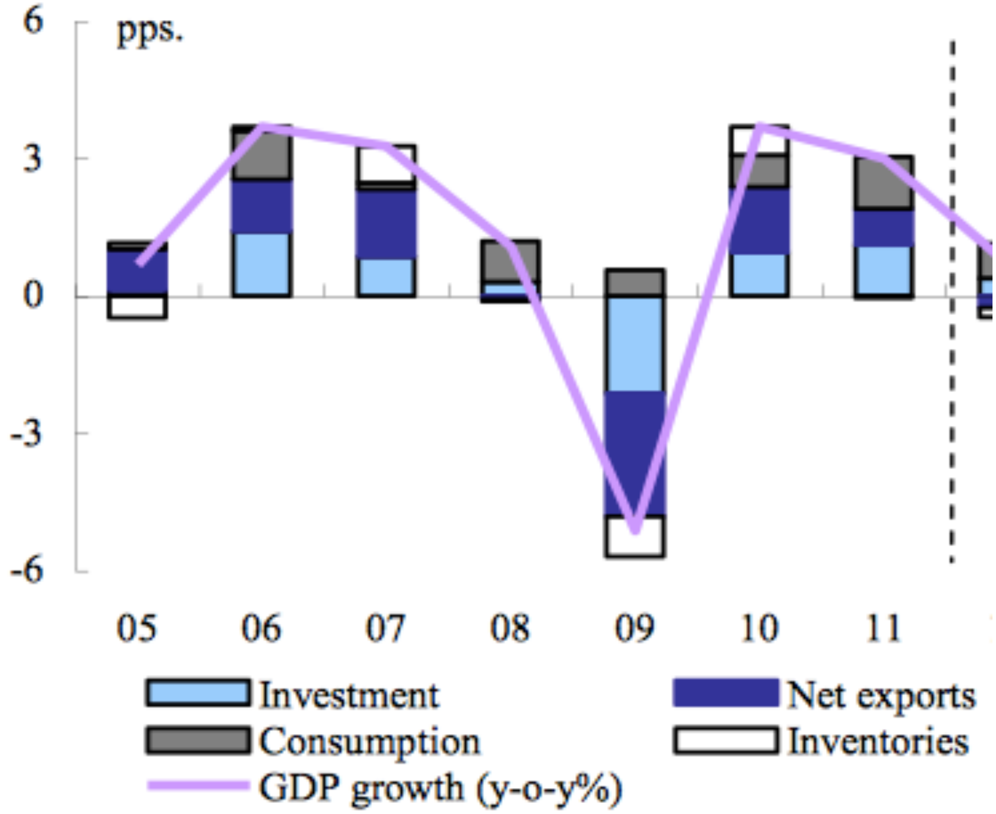
period by 3.9 percentage points and the UK by 4.4 percentage points. Italy's real GDP even shrank by 2.1 percentage points after the Great Recession (IMF 2013). Doing better then others is quite an achievement but still it is a far shot from being a strong growth economy (graph 5)

Graph 5 Real GDP- Growth, 1999-2011



Given the structural features of the German economy it comes as no surprise that the export sector contributes significantly to the growth of German GDP. Of course, this structural features works positively as well as negatively. When the Great Recession hit, German export sectors were strongly affected (see graph 5). The recovery of the global economy - not least pushed by enormous deficit spending programs of governments as well as the rescuing of the financial sectors with the help of large assistance programs and accommodating monetary policies - turned out to be the critical trigger for the German version of recovery. The well-positioned export sectors made up their market losses in the Eurozone by strengthening their focus on the growth poles of the global economy, and they did well. Already in 2010 the contribution of *net exports* to the growth of GDP was stronger then the contribution of any other component (graph 5). In this respect it is true that Germany's recovery was helped by the improvement of growth conditions in other parts of the world. Rather then improving its domestic sources of economic growth Germany again relied on the strength of its export sectors in order to generate economic growth.

Graph 5 Contributions to German GDP Growth, 2005 - 2011

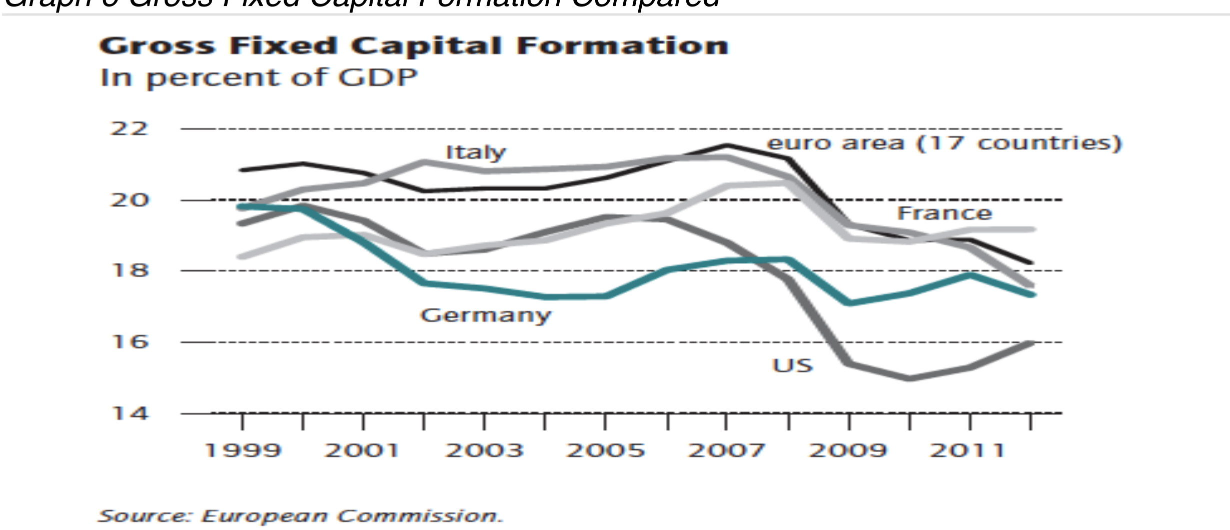


Source: EU Commission, 2013

And yet, what is being praised as a huge economic achievement hints actually to a serious underlying problem. The combination of steady and high trade balance as well as current account surpluses with relatively low growth rates of GDP refers to an underlying problem of the German model. Steady surpluses can be an annoyance for the rest of the world and in particular for economies who run the bulk of their deficits with Germany. As long as the surpluses are recycled in an orderly manner and the capital imports are used appropriately such a imbalance can work for quite a while. In the best of all worlds the import economies are using the external resources to modernize and catch up on all levels, and over time the imbalance starts to disappear. The capital exporting economy, on the other side, is not giving away its goods and services for free but actually earns interest income that spurs its economy.

Unfortunately, the world in general and the German economic world is not as perfect as assumed in this line of argument. The catch–up processes turned out to be highly distorted, in particular in the southern periphery of the Eurozone. Rather then channeled into productivity-enhancing activities most of the capital inflows fuelled large real estate bubbles, and actually undermined the growth models of those economies. The story did not go well for the creditor economy, either. Germany may not be unique but still is a excellent case of high savings, high current account surpluses and low private as well as public investments. Germany has one of the highest savings rate of all the OECD-economies that averages more then 20 % since the late 1999s and reached new heights in the last years when it went up to 26%. At the same time, Germany has a seriously low investment share (see graph 6).

Graph 6 Gross Fixed Capital Formation Compared

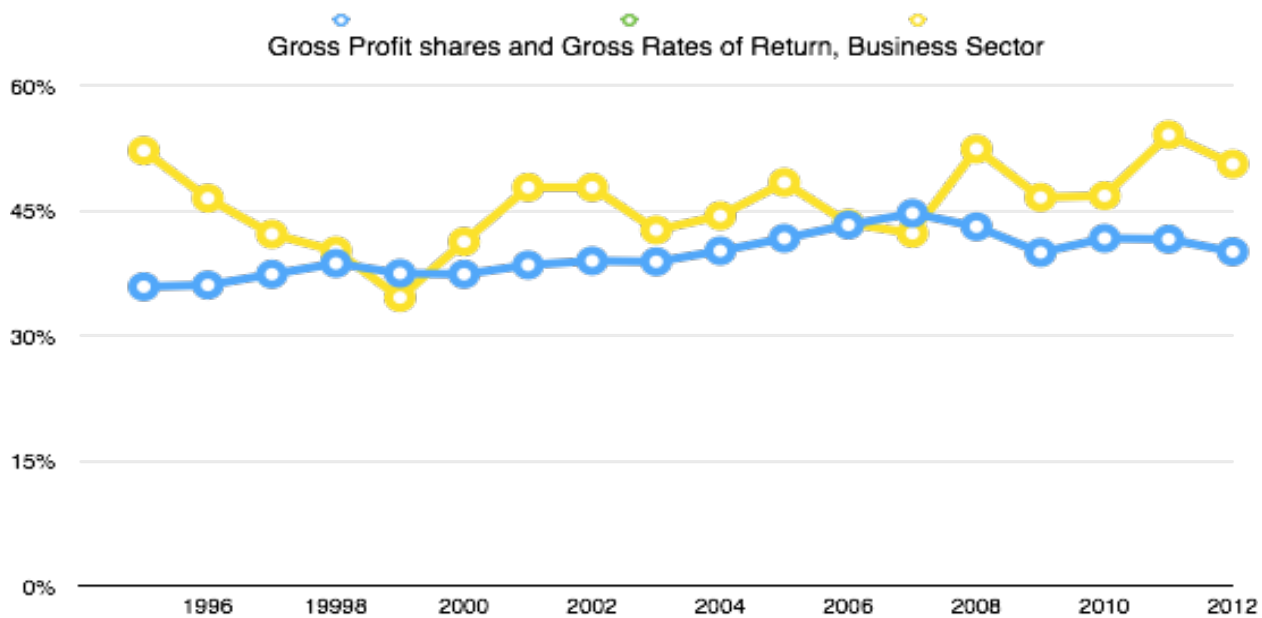


This is a potentially explosive mixture, especially if one adds the additional feature that German investments abroad did not pay off as well as investors may have expected. According to a recent study German investors actually experienced serious losses:

‘Since 1999, German investors have lost approximately 400 billion euros on their foreign assets, which corresponds to around 15 percent of the country’s GDP. In the period between 2006 and 2012 alone, the figure was even as high as 600 billion euros, or 22 percent of GDP’ (Bach et al 2013:10f.).’

Losses in this range are quite substantial, and indicate that the management of current account surpluses and high savings was neither efficient nor in any case satisfying. Over the same period the German business sector experienced a slight improvement in regards to the gross profit share as well as to the gross rate of return (see graph 7).

Graph 7 Gross Profit Share and Gross Rate of Return, Business Sector



profit share
rate of return

Data: Eurostat

1 Profit share non-financial sector. Calculated in % as: gross operating surplus / main financial liabilities – assets
2 Rate of Return: Calculated in % as: gross operating surplus / main financial liabilities - assets

According to Eurostat data, both indicators show values far above the

Eurozone average, and thus indicate overall favorable investment conditions for the German non-financial business sector. Those conditions, however, did not translate in buoyant private investment. The main reason can be found in overall weak effective demand from the consumption side as well as from the public sector. Former is closely connected to the increasingly unequal distribution of income and wealth; latter is the outcome of restrained public budgets due to the anticipation of the coming 'Schuldenbremse' as well as of the guidelines of the Stability and Growth Pact.

All those factors are highly politically loaded, and thus should be open for change. And yet German economic policy making is trapped in a self-inflicted double bind. In economic terms it would be rational and also necessary to significantly increase public investment in crucial areas of modernization but this would conflict with the strict criteria of the 'Schuldenbremse' and the SGP, both regulations that were spearheaded by both parties that make up the current coalition government. In contrast, correcting the unequal distribution of income and wealth should be an easier political task. Such a project would require a fundamental overhaul of the tax code and thus sufficient political will power as well as political resources. It needs only a brief review of the coalition contract to recognize that both those virtues are missing. Rather then positioning the German economy as the growth motor of the Eurozone and thus to lifting it on a new growth plateau that simultaneously creates positive external spillovers and domestic job and income effects the German government decided to special interest in order to consolidate respective power relations.

Gros/Mayer (2013) recently suggested a seemingly elegant way out of this double bind by proposing the launch of a German Sovereign Wealth Fund. This proposal is based on the idea of 'excess savings' in Germany that are not absorbed by domestic investment and thus result in current account surpluses. As already shown this interpretation is valid in a bookkeeping manner. An official sovereign wealth fund would offer German savers a secure saving opportunity that comes with a guaranteed positive minimum real interest rate. In case of favorable macroeconomic circumstances this positive minimum rate would automatically increase. (Gros/Mayer 2013:5). The Sovereign Wealth fund would then recycle the savings into long-term investments abroad, very much in the manner of already existing sovereign wealth funds like the ones established by Norway and Japan. Such a management of current account surpluses would offer relief for an overstretched private banking industry and also prevent that a mechanisms like TARGET2 would be overused. Gros/Mayer also make the point that the more funds would be invested outside the Eurozone, the stronger would be a potential depreciation effect on the Euro exchange rate that then again would improve the price competitiveness of the southern periphery[7].

The project of a German Sovereign Wealth Fund seems to me valuable *if* it comes with distinct institutional features that deviate from the Gros/Mayer-proposal. **First**, in line with Gros/Mayer such a fund has to offer a positive real interest rate for private savings and more generally spoken a interest rate that is *always* above the market rate. Only such an incentive can ensure a critical inflow of funds. Such a fund provides an alternative to private financial institutions and corrects the suffering transformation of private savings into long-term public investments. **Second,** the difference between market interest rate and wealth fund rate creates a structural deficit for the wealth fund that needs to be covered. This will be the task of a newly introduced wealth tax. As it has been, inter alia, proposed by Bach et al (2011):' Since net wealth is strongly concentrated at the top of the distribution, a capital levy could raise substantial revenue, even if relatively high personal allowances are granted, thus restricting the number affected to a very small percentage of all taxpayers. Assuming a personal allowance of Euro 250,000 we estimate a tax base of Euro 2,950 billion amounting to 118 percent of GDP in 2010. A capital levy raising tax revenue in the amount of Euro 100 billion, or 4 percent of GDP, would thus require a tax rate of 3.4 percent.' In other words, financing the interest rate differential with a capital levy on net wealth not only provides financial means to cover the gap but also contributes to an improvement in wealth distribution. **Third**, rather then investing the resources abroad the means of the wealth fund will dominantly be used for financing domestic public investments. Such an allocation will close the large public investment gap, prepare the German economy better for the challenges of today's global economy, and provide the base for a much more balanced domestic growth model. Given the input-output structure of the German economy one can safely expect that such a pre-dominantly domestic use of the means of the wealth fund would have strong spillover effects and thus increase the import demand of Germany. Neighboring economies, including the southern periphery, would benefit from this policy project enormously, and Germany's current account surplus would drastically shrink – without undermining in any way its export sectors.

This modest policy proposal is out of reach, though. Rather then putting a forward strategy on its agenda the black-red coalition government seems to have given up and prefers to cozy up – no problem in a situation without any powerful opposition.

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[7] Obviously the same holds for the German export sectors. Thus the launch of an sovereign wealth fund may rather strengthen then weaken its current account surpluses.