Germany's Virtuous Economy: How Much is It to Blame?

Angel Ubide argues that Germany should rebalance its growth, allow wages to grow, and encourage domestic demand to help countries like Greece, Spain, Portugal, and Italy.

Steve Weisman: Europe continues to suffer the crisis that erupted in Greece, and it may be spreading to other parts of the region. This is Steve Weisman at the Peterson Institute for International Economics, with Angel Ubide, a visiting fellow here at the Institute, to talk about how we got to where we are. Angel, thank you very much for joining me.

Angel Ubide: Thank you.

Steve Weisman: Tell us your analysis of how we got to this point.

Angel Ubide: It's a complex situation because, to some extent, I think this had started with the German unification and then the process of euro area integration. And I mentioned German unification because that resulted in significant deterioration of German competitiveness, after the conversion of the currency, and that to some extent was the beginning of the process.

Steve Weisman: In other words, when the euro was set up, it locked in a kind of competitive disadvantage for Germany, which was one reason why the rest of the European countries were willing to [go] along with it?

Angel Ubide: To some extent. What really happened—I remember back in 1996–97 there were several studies circulating that were suggesting that Germany was about 20 to 30 percent overvalued in real effective terms. And so, when the locking of parities happened in the late 1998–99, essentially Germany was still at a loss of competitiveness with respect to other trade partners inside and outside the euro area.

Steve Weisman: What did Germany do to overcome that disadvantage?

Angel Ubide: They embarked in this policy of wage disinflation, of regaining competitiveness, which definitely was weird to us because one has to realize that unit-labor costs in Germany were essentially flat or even growing negatively during most of the last decade. But at the same time, that generated a disinflationary pressure into the whole euro area that I think set the stage for a policy mix of both monetary and fiscal policies, which for some countries in the euro area was perhaps too expansionary. And I think that we need to add a final point here. The European authorities set up the Stability and Growth Pact as a way of containing fiscal deficits. But fiscal policy unfortunately is asymmetric.

It's very difficult to generate a very large fiscal surplus. Let me give you the example of Spain, where there is a perception that there is a deficit in infrastructures, for example. It's very difficult when you are in 1 or 2 percent fiscal surplus to say, "I'm going to expand it to 4 percent," when a part of the population is saying, "Why don't you build better roads?" And that's where I think it was a key problem of constructing policymaking in the euro area: the asymmetry in the fiscal policy mix.

Steve Weismann: But there was also an accumulation of current account surpluses that helped Germany as an exporting power that also led to this crisis. Can you explain that?

Angel Ubide: It's the issue of the internal imbalance of the euro area. This was a debate that happened really in the 2005–2006 period, where basically the current account surplus in Germany started to balloon and the current account deficit in some countries like Holland, Spain, and Greece started to increase.

And the debate back there was, well, it doesn't really matter from a funding standing point. It matters because it's signaling an imbalance—an overheating inside those economies that are running the current-account deficits. I have to say that very few people thought that the other side of [the] argument—the running of current account surpluses—could be also part of the problem. And I think that now, we are realizing that the imbalance is bad on both sides.

Steve Weisman: Some people make the analogy between China and the United States.

Angel Ubide: It's a bit different in that Germany is not really manipulating an exchange rate. It's not really keeping an exchange rate artificially fixed. It's just achieving a policy, if you want, of moderation and fiscal discipline. We can have different views about whether that's the right way or not, to proceed in the current context.

Steve Weisman: You do hear some critics suggesting that Germany should somehow change its virtuous behavior. But what should Germany do?

Angel Ubide: Imagine if Europe had a Federal fiscal policy framework. You'd have some countries—such as Greece, Spain, Ireland, Portugal—who are in a difficult fiscal situation, and especially in a difficult economic situation. What would the Federal fiscal system do? It will redistribute funds toward those areas of the country. In this case, those countries that are in a worse economic situation. Well, we don't have a fiscal Federal system in Europe but we have different countries with different fiscal positions.

So where I think the economies are driving that—and some people are arguing, and I would agree is that Germany could now try to expand its domestic demand as a way of contributing to the growth of the periphery areas that are in need of growth. Whether you achieve that by expanding fiscal deficits now or by raising public wages, it's something that we can discuss. So it's not necessarily an issue of asking Germany to lose competitiveness. It's a question of asking Germany to boost overall growth, mostly via domestic demand.

Steve Weisman: Is that a realistic thing, politically, to ask Germany to do?

Angel Ubide: It is difficult, simply because there is a generalized view out there—and in some of the papers at the IMF I know they have written—that the state of public finances across the board is unsustainable after this crisis. So it's a little bit complicated from a political standpoint to ask one country to generate a bigger deficit at this particular juncture. But at the same time, I think what is at stake at this moment is the structure of the euro area. The structure of the euro area we have seen is incomplete. We have a monetary policy that is common, we have a very rapid integration of financial markets. But we have kept fiscal policy, domestic-national, and the big supranational component I think is missing. It was thought that it was not going to be necessary because there would be coordination. But now it seems that that coordination is not as perfect as we thought it would be.

Steve Weisman: Germany's response to this crisis came in the form of a proposal for a European Monetary Fund but France seems to be saying, "Not so fast." Is there going to be a sort of disagreement between France and Germany over this?

Angel Ubide: Well, there appears to be one, at least in public because they are trading, essentially, op-eds and interviews in the international media.

Steve Weisman: Good for the op-ed business.

Angel Ubide: I just think that the issue really goes beyond the European Monetary Fund because we need to open the dialogue beyond fiscal policy and into a broader coordination of economic policies. I think it was also a clear message from the last ten years that structural reforms are also asymmetric. It's very difficult to do a good structural reform when the times are good. And so, it is really complicated in this kind of framework that we have, to continue to move if we only focus on fiscal policy, which seems to be in the attempt that the German authorities are trying to do now.

Steve Weisman: Angel, thank you very much. Let's have you back as this unfolds.

Angel Ubide: Definitely, my pleasure.

Steve Weisman: Thanks.