Germany's Balance-of-Payments Surplus

The great strengthening of the international economic position of West Germany has been one of the most striking aspects of that country's remarkable postwar recovery.[1] By 1951, the country's exports had surpassed those of an undivided prewar Germany. Since then, they have more than trebled, making Germany the largest exporting nation in the Free World after the United States. This sharp rise in exports has occurred while other special supports (developed when there was still concern over German weakness) have also gone on increasing. The most notable among these special factors have been foreign exchange receipts from the United States and other NATO forces stationed in Germany. Recently, Germany's trade earnings and special receipts have also been supplemented by short-term capital inflows, enlarging Germany's balance-of-payments surplus during January-September 1960, to a record annual rate of about $2 billion. The German Federal Bank's gold and net foreign exchange holdings have risen almost uninterruptedly for the last ten years, reaching $7½ billion at the beginning of November—the largest international currency reserve of any single Free World country except the United States. In the current year, the German surplus represents the counterpart of roughly half of the very large United States dollar deficit.

Although this strong balance-of-payments position has helped make the German mark one of the world's hardest currencies, the continued large-scale accumulation of reserves has posed a serious dilemma for German monetary policy in recent years. This dilemma—which a number of other countries also have faced—is the problem of pursuing a policy of monetary restraint at home, while at the same time attempting to avert the foreign exchange gains that are the frequent by-product of this policy and which add to domestic liquidity. The Federal Bank has been well aware that further exchange inflows eventually could not be offset effectively by monetary restraint alone. In its 1959 annual report, the bank declared that, if these inflows continued, it would be forced to continue to offset them "in order to make its credit policy effective. . . . Clearly, however, it would be easy to expect too much of the bank in connection with such a more or less permanent stiffening of the measures affecting liquidity."

The sustained flow of gold and foreign exchange to Germany has also been of concern to its trade partners. The persistent gravitation of reserves to one country involves a heavy drain on other countries' reserve holdings, and if left unchecked would seriously unbalance the entire international payments mechanism. During the mid-fifties, the European Payments Union nearly collapsed under the weight of Germany's large surpluses, and only substantial German credits to the EPU kept the latter functioning. As the dollar position of European countries improved and convertibility of European currencies into dollars (for nonresident holders) was restored at the end of 1958, the German surplus ceased to be a threat to the payments mechanism in Europe. At the same time, however, the increased use of dollar earnings by European countries to cover their deficits with Germany transferred the burden of the German surplus more fully onto the United States dollar.

Against this background, the present article, after examining the factors underlying the German balance-of-payments surplus, describes the measures that have already been taken to correct the payments imbalance and indicates some of the possibilities for further action in the future.

HE BALANCE-OF-PAYMENTS SURPLUS

During the first three quarters of 1960, the over-all German balance-of-payments surplus was running at an annual rate of about $2 billion (see table). Aside from short-term capital inflows, the two major elements in this surplus were the trade surplus of over $1 billion and the receipts from the United States and other NATO troops stationed in Germany, also about $1 billion annually.

Germany's trade surplus rose progressively from 1955 to 1959, as a result of a 60 per cent rise in exports and only a 46 per cent increase in imports (see Chart I). During the first ten months of 1960, however, imports rose faster than exports, partly because of sharply increased imports of military goods, and the trade surplus has consequently remained about 10 per cent below last year's level.

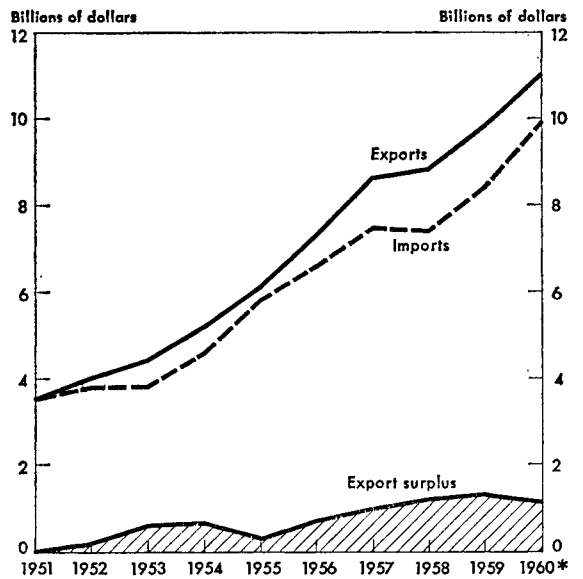
A number of factors, some of a structural nature, underlie the trade imbalance. One of the most influential has been Germany's relatively low import demand as com-

[1] For a discussion of Germany's postwar recovery, see "Growth and Price Stability: The German Experience", *Monthly Review*, February 1960, p. 29.

pared with prewar years. Decades of tariff protection and especially the attempts at self-sufficiency during the 1930's appear to have conditioned the German economy to import-saving and to have encouraged efficient exploitation of the country's own material and human resources. Moreover, there has been an enormous expansion since the war in the production of capital goods, which in Germany have a relatively low content of imported raw materials. From 1955 to 1959, while industrial production climbed by 26 per cent, imports of raw materials rose only 6 per cent. Similarly, the proportion of raw material imports to total imports declined steadily from 36 per cent in 1951 to 22 per cent in 1959.

On the export side, the conspicuous increase in German exports—from $1.9 billion in 1950 to $9.8 billion in 1959—has reflected both strong foreign demand for German goods and the German ability to meet this demand. During the postwar period, the generally high level of economic activity throughout the world and, for most of these years, the inflationary pressures in competing countries created a sellers' market for such German products as machinery, cars, and other highly specialized finished products. Moreover, until fairly recently many countries discriminated against imports from the United States and thus had to look for other sources of supply. Germany offered such a source, especially for capital equipment, the more so since during the years immediately following the Korean war the country did not have to devote a large part of its resources to a defense establishment of its own. Even now, when German rearmament is under way, defense outlays amount only to about 4 per cent of the gross national product as compared with 9 per cent for the United States. Moreover, German fiscal and monetary policies have both been almost consistently on the restrictive side. They have kept aggregate internal demand within limits that have left an increasing margin of productive capacity for exports, while at the same time limiting price increases and keeping them within a highly competitive range.

Chart I
GERMAN FOREIGN TRADE



* January-October at annual rate.
Source: International Monetary Fund.

Another important element in Germany's export performance has been the official export-promotion program. Throughout the past decade, the government has supported a large export-credit insurance system, under which export guarantees covering both economic and political risks have been made available to German exporters. In addition, the government has granted tax advantages to exporters by refunding turnover and other taxes on goods sold abroad; it has been calculated that such tax rebates have allowed exports to be priced as much as 12 per cent below the prices listed at home. This policy of active encouragement of exports contrasts with the imposition of a 4-6 per cent turnover equalization tax on most imports in order to equal the turnover taxes borne by similar domestic products; furthermore, little progress has been made in liberalizing agricultural imports.

Receipts from the United States and other NATO forces have been about as important as the trade surplus in contributing to the over-all payments surplus. In 1959, such receipts amounted to $981 million, or more than

Germany's Balance of Payments
In millions of dollars

Item	1957	1958	1959	1960*
Current account:				
Balance of trade	+ 972	+1,179	+1,276	+1,091
Balance of services	+ 183	− 227	− 549	− 462
Surplus on trade and services	+1,155	+ 952	+ 727	+ 629
Receipts from NATO troops	+ 633	+ 923	+ 981	+1,010
Balance on current account	+1,788	+1,875	+1,708	+1,639
Unilateral payments†	− 392	− 392	− 627	− 603
Capital account:				
Long term	− 173	− 446	− 895	− 373
Short term	− 408	− 122	− 565	+ 529
Balance on capital account	− 581	− 568	−1,460	+ 156
Balance on current account, unilateral payments, and capital account	+ 815	+ 915	− 379	+1,192
Errors and omissions	+ 403	− 156	− 120	+ 857
Changes in official gold and foreign exchange reserves	+1,218	+ 759	− 499	+2,049

* January-September at an annual rate.
† Primarily indemnification payments to Israel and to victims of Nazi persecution resident in other countries.
Source: Adapted from the German Federal Bank October 1960 *Monthly Report*.

three times as much as in 1955; so far this year, there has been a further small rise. Of these receipts, about 80 per cent comes from United States troops and the remainder from British and other NATO forces. In order to assist Britain on this score, Germany agreed early last year to pay a lump sum of $100 million in support of British troops in Germany; the third and final instalment was paid this spring.

Some offset to the trade surplus and the foreign exchange receipts from NATO forces has in recent years been provided by sizable net deficits on service transactions, on so-called unilateral payments, and on long-term capital account. As regards services, sharply rising German tourist expenditures and net outpayments of income on foreign investments in Germany have been instrumental in changing the service account of the balance of payments from a $183 million surplus in 1957 to a $549 million deficit in 1959. "Unilateral payments", consisting mainly of indemnification payments to Israel and to victims of Nazi persecution resident in other countries, have increased markedly and stood at an annual rate of $603 million in the first nine months of this year, although these are not necessarily a continuing flow. There has also been a deficit in Germany's long-term capital account, particularly because the German Government must make annual repayments on its external debt and German residents generally have been net purchasers of foreign securities. The total of these various net payments during January-September 1960 was equivalent to an annual rate of nearly $1.5 billion and thus exceeded the trade surplus by a substantial margin, although still far short of the combined trade surplus and NATO troop receipts.

Over the past fifteen months, moreover, the inflow of short-term capital has aggravated the German external surplus considerably. After the current boom began to develop in the summer of 1959 and the Federal Bank tightened credit substantially by a series of measures, German banks repatriated the bulk of their foreign short-term assets. From August 31, 1959, just before these measures were adopted, to September 30, 1960, banks drew down these assets by $530 million to around $240 million (about the level at which they had stood before the Federal Bank started to encourage the outflow of short-term funds at the end of 1958—as noted below). During the same period, German banks also increased their short-term borrowing abroad at an accelerated pace and outstanding borrowings rose from $67 million to $257 million. Even more important, a large volume of short-term funds moved into Germany, as German industry directly borrowed from abroad and as payments for imports were delayed and payments for exports speeded up. No official statistical record is kept of such short-term movements, and these movements accordingly are included in the balance of payments under "errors and omissions". This latter item accounted for about $610 million, or about 42 per cent of official reserve gains during the second and third quarters of this year.

IN SEARCH OF BALANCE-OF-PAYMENTS EQUILIBRIUM

The German authorities, concerned about the huge and persistent external surplus, have taken a number of corrective measures during the last few years. In a move to curb domestic inflationary pressures as well as to reduce the trade surplus, they lowered tariffs on most industrial products by nearly 50 per cent in 1956-57. Partly as a consequence, imports of finished products rose by 138 per cent from 1955 to 1959, and their share in total imports increased from only 19 per cent to 31 per cent. However, in view of the sluggish rise in imports of raw materials and food products and the very sharp rise in exports, these tariff cuts failed to prevent the trade surplus from almost doubling from 1956 to 1959.

In the first eight months of 1959, the German authorities sought to moderate Germany's foreign exchange gains by stimulating the outflow of short-term funds. During almost this entire period the Federal Bank kept its discount rate at 2¾ per cent, the lowest in the history of German central banking, and also extended forward cover at below market rates or at no cost at all to commercial banks desiring to increase their short-term dollar assets. The banks responded well to these efforts, and increased their net foreign exchange position by $570 million during January-August 1959. At the same time, the German Government made substantial advance payments on military purchases abroad as well as on its external debt. However, although these efforts were effective in reducing official reserves and easing the upward pressure on the mark, they could not provide a lasting solution to Germany's payments problem. As noted above, the Federal Bank in the fall of 1959 deemed it essential to tighten credit in order to curb excessive internal demand. The German banks thereupon started to repatriate the foreign short-term assets they had built up in early 1959, thus swelling the official reserve inflow to very large proportions.

While the Federal Bank accepted the repatriation of German short-term funds as an unpleasant, though unavoidable, consequence of its restraint policy, it took a series of measures to limit the inflow of foreign short-term

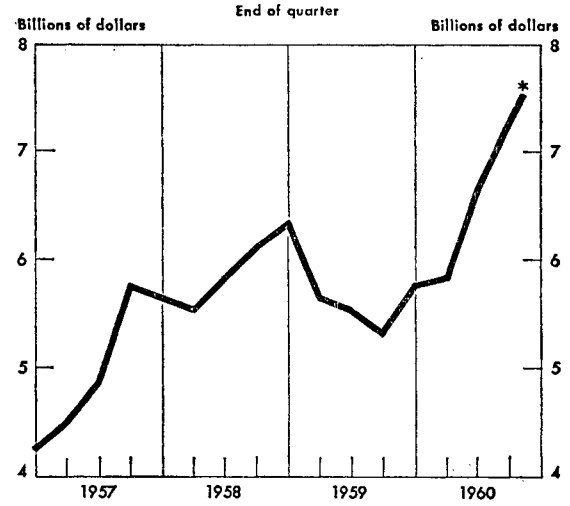
funds that were attracted by the rising German interest rates. As of last January 1, the bank raised to the legal maxima the reserve requirements against increases in foreign-owned sight, time, and savings deposits above their November 30, 1959 levels. Effective July 1, German credit institutions were prohibited from paying interest on foreign-owned sight and time deposits (but not on savings deposits), as well as from selling money market paper to nonresidents. At the same time, the bank withdrew an earlier regulation under which the German banks' foreign-owned deposits, if offset by foreign-currency assets, had been exempt from reserve requirements—a move that probably has particularly discouraged the acceptance of Continental dollars by German banks.[2]

Judging from the decline in foreign deposits with German banks since the end of May, these steps appear to have had some effect. However, the measures did not prohibit German banks from paying interest on foreign-owned savings deposits and did not prevent nonresidents from buying German stocks and bonds, purchases of which appear to have risen sharply during the last five months. Moreover, the measures did not affect short-term borrowing abroad by German banks and corporations, which, as noted, has gained momentum in recent months, particularly as regards the financing of import credits. Such short-term borrowing abroad continued despite the Federal Bank's willingness, since the end of August, to enter into dollar-swap transactions with German banks, for periods of up to six months, under which it would buy forward dollars at a premium of 1 per cent per annum above the rate for the spot sale—a premium that was raised to 1½ per cent at the end of September. Finally, since all these efforts had focused on the short-term capital inflow, which is largely a symptomatic and aggravating factor in the surplus problem, they proved inadequate to dispel rumors of a German mark revaluation—rumors that further raised Germany's foreign exchange gains during recent months, despite the clear determination of the German authorities to take no action of this kind.

Chart II

GERMAN OFFICIAL GOLD AND FOREIGN EXCHANGE RESERVES

End of quarter



Note: Official reserves include the German Federal Bank's holdings of gold, foreign exchange, bonds and notes of the International Bank for Reconstruction and Development, and Germany's net bilateral claims arising from the liquidation of the European Payments Union.

*As of November 7.

Source: International Monetary Fund.

A NEW POLICY APPROACH

By the fall of 1960, it became obvious that the various policy measures, largely undertaken by the Federal Bank alone, had been insufficient to prevent the flow of foreign exchange into Germany from mounting to alarming proportions (see Chart II). In the first ten months of the year, the reserve gains averaged almost $40 million a week and even exceeded $100 million in some weeks. The German Government itself has therefore announced its intention to make a start toward cutting down the German payments surplus by more fundamental measures.

In reaction to a growing body of opinion that Germany should assume a larger share of economic-development assistance, the government now has in process several plans for increasing Germany's foreign aid contributions. Under a draft bill just submitted to parliament, the government will make available during the next five years $360 million for long-term loans to less developed countries. These funds are to be derived from interest on loans financed by former Marshall Plan counterpart funds, about $50 million annually, and from the sale of the Federal Government's interests in the Volkswagen works, about $120 million. Further, German industry, banks, and insurance companies will subscribe to a fifteen-year 5 per cent $360 million special Federal Government loan, the proceeds of which also are to be used for long-term foreign aid. Also, the German States, which recently have accumulated large budget surpluses as a result of high tax revenues, have agreed to make some funds—perhaps $140 million—available to the Federal Government for the purpose of financing foreign aid. Finally, a small amount may come from the Federal Government budget itself, depending on whether some budgetary economies

[2] See Alan R. Holmes and Fred H. Klopstock, "The Market for Dollar Deposits in Europe", *Monthy Review*, November 1960, p. 197.

can be realized. In total, these proposals could provide about $800 million of German capital for prospective foreign aid projects. However, actual outlays might be spread out over several years, so that the capital outflow each year might be relatively small as compared with the current annual balance-of-payments surplus of $2 billion.

Most of these funds would be made available to the Reconstruction Loan Corporation (Kreditanstalt für Wiederaufbau), which is widely favored in Germany as the most appropriate institution to administer an expanded foreign aid program. The corporation, owned half by the Federal Government and half by the States, was set up in 1948 primarily for the purpose of channeling, on a loan basis, part of the European Recovery Program funds to German industry. In addition, the corporation's charter authorizes it to raise funds on the capital market, which it has done increasingly during recent years. Since 1958 it also has engaged increasingly in foreign lending, using both ERP funds and funds raised on the market. In 1959, it made several foreign commitments totaling some $153 million—about 25 per cent of its total credits extended last year—in connection with long-term credits granted to foreign companies for specific projects or to various foreign governments. Earlier this year, the German authorities indicated that the corporation would be given a leading role in German economic development loans—a view that has found wide support since it has been operating for more than ten years and possesses large and diversified assets.

These steps, once implemented, would represent a promising start toward closing the gap of recent years. In addition, the German Government has expressed its willingness to increase its contributions to NATO. A semiofficial publication of the German foreign ministry recently stated that: "If the justified concern of the United States Government meets with a common acceptance and a common solution by the NATO allies, the Federal Government is willing to make a suitable contribution within this framework". Such an increased contribution to NATO, together with President Eisenhower's new directives to reduce official United States dollar outlays abroad —of which Germany has been a major beneficiary—may go considerably further toward reducing or offsetting that part of Germany's large foreign exchange receipts that arise from the presence of NATO troops in Germany.

The authorities are reportedly hoping to make a further contribution toward a narrowing of the external surplus by putting more emphasis on fiscal and other restraints, in order to relieve monetary policy of some of its present heavy responsibility for checking excessive demand. Funds made available for foreign aid should help not only to reduce the payments surplus, but also to mop up domestic liquidity. The Federal Bank has welcomed this prospect, and on November 11 felt able to reduce its discount rate to 4 per cent from 5 "exclusively with a view to the external monetary situation" (see also page 219 of this *Review*). Thus, the bank's insistence on greater reliance on fiscal and other nonmonetary types of restraint to curb domestic liquidity finally seems to be bearing fruit. In its October *Monthly Report,* the bank underscored once more the need for such a shift, stating that the recent heavy foreign exchange inflow "has paralyzed to a considerable extent the effects of the credit restraint policy and has more clearly than ever demonstrated the conflict between the domestic and external aspects of this policy".

CONCLUDING COMMENTS

During the past year, the distorting influence of a continuation of Germany's unusual balance-of-payments surplus has become clearly recognized, both inside and outside Germany. The responsibilities of a "good creditor" country are now being defined, within the context of the various unique aspects of the German situation. The German authorities seem agreed that special action is necessary.

There is much to be done purely in terms of normal trading relationships, both to avoid serious raising of tariff barriers as the Common Market comes into force and to reduce present impediments to imports—not only imports from the United States and other industrialized countries, but also those from the struggling newer countries that need markets if their growth is to be balanced and sustainable. Much has already been done by the Federal Bank with a view to slowing capital inflows, but these efforts have not prevented a continued inflow of short-term capital, nor could they have been expected to bring about by themselves the more fundamental balance-of-payments adjustments that are required. Thus, much more remains to be done in the areas that are closely dependent upon the stimulation or encouragement, or even direct participation, of the German Federal Government itself.

While the United States Treasury-State Department mission of consultation in late November did not yield specific results, there is no doubt that the nature of the problem has been brought more clearly into focus, both in the United States and in Germany. The start already made by the German authorities on many fronts and the broad range of their further proposals suggest that a comprehensive program of remedial action is in the making.