

On The US-Germany Imbalance Paul Krugman

Trump's tweet on German-US trade was, it goes without saying, deeply stupid and destructive. He obviously doesn't get how the EU works – it's a customs union, so there is no such thing as bilateral trade policy. He also thinks that bilateral trade balances are the test of fairness, which is all wrong. Somewhat annoyingly, there is a real issue lurking behind all of this: Germany's excessive overall surplus, the consequence of inadequate spending and deflation in the aftermath of the euro crisis. https://krugman.blogs.nytimes.com/2017/05/27/germanys-real-sin/?_r=0 But insulting a key ally on obviously fallacious grounds is no way to help with that issue.

But never mind all that. I found myself wondering about the causes of the underlying fact: Germany does indeed have a huge bilateral surplus with the US, exporting about 2.5 times as much to us as we sell in return. <https://www.census.gov/foreign-trade/balance/c4280.html> Why?

Somewhat surprisingly, there's not a lot of economic literature on the causes of bilateral trade imbalances. Davis and Weinstein (DW) had a nice empirical examination: http://www.columbia.edu/~dew35/PDF/Bilateral_Mysteries.pdf

They concluded that the standard explanations didn't explain much, that overall there was a lot more imbalance in the world than there "should" be. Still, I think it's interesting (although maybe not important) to ask what we can say about the reasons for this particular imbalance.

As DW say, one theory of imbalances is macroeconomic: countries that save more than they invest will run surpluses, countries that invest more than they save will run deficits, so when a big saver trades with a big spender, big imbalances are to be expected. And that's certainly part of the story.

But not all. Overall, Germany exports about 25 percent more than it imports, America imports about 50 percent more than it exports. The bilateral imbalance is a lot bigger than either of these.

The other story DW tell is about "triangular trade." Here's my version: think of a world containing three countries, Spendthriftia, Austeria, and Petrostan. The first two mainly sell manufactured goods, which are differentiated products so there's a lot of two-way trade. The third sells raw materials, which it trades for manufactures. However, Spendthriftia also produces a lot of raw materials, e.g. by fracking, which makes it relatively less reliant on imports.

What we would expect to see here, *even if each country's overall trade was balanced*, would be a pattern of bilateral imbalances: Austeria running a deficit with Petrostan, Spendthriftia a surplus with Petrostan, but Austeria running a surplus with Spendthriftia. Now think of this

effect overlaid on the macroeconomic imbalances, and you get something that looks more like the actual US-German bilateral story.

But wait, there's more. I suspect that part of the US-Germany bilateral imbalance is an optical illusion, brought on by transshipment. If you look a bit more at US trade data, you find that we do an awful lot of trade with the Netherlands, and we run a huge surplus in that trade <https://www.census.gov/foreign-trade/balance/c4210.html>. A big surplus with Belgium, too. Surely this represents US exports unloaded at Rotterdam or Antwerp and then shipped on to other EU destinations, including Germany. I'm not sure why German exports to the US don't go the same route; insights from people who know are welcome.

Again, the policy relevance is basically nil. But it might be a good idea to have more research on bilateral trade imbalances, if only to make dissing Trump tweets even easier.