Foreign Affairs Comments on Stealth Currency Manipulation by the German Government

There continues to be much talk of currency manipulation with China and Japan usually identified as the main culprits. While there is no doubt that these two have long managed kept their currencies undervalued to boost exports, today's main practitioner of the black art remains hidden.

Unidentified and even herself not fully aware of what she is doing, the German ship of state sails blithely along, racking up record trade surpluses and wreaking havoc in its wake.

Yes, I said Germany. I know it gave up its beloved deutsche mark to join the euro zone and I know that the euro floats and is itself not a manipulated currency like the yuan, the yen, the Swiss franc, and the Brazilian real. But the truth is that the euro is not really a single currency. For instance, does anyone believe that the euro used in Cyprus is the same as the one used even in Greece let alone Germany? Does anyone think that the Spanish euro is the same as the German euro? To ask the question is to answer it.

The EU economy is far from the integration of the U.S. or Chinese markets. This is true in many respects, but most glaringly in finance. The EU may have a common currency but it certainly does not have a common banking or financial system. And here is where the essence of German currency manipulation is most apparent. It is the Germans who have steadfastly resisted any common guarantee of national debts and any common bank supervisor.

The differences in the various euros can be seen in the different interest rates that EU governments pay on their euro bonds. Germany is presently paying 1.58 percent on its long term debt. This compares to a bit over 10 percent for Greece, 6.3 percent for Portugal, 4.67 percent for Spain, 4.38 percent for Italy, and 1.88 percent for Finland just to cite a few examples.

Because the European Central Bank sets a common short term interest rate for short term euro debt and because the eurozone countries all price their exports and domestic transactions in euros, we have the illusion that they use one currency. But the truth is that the international rate of exchange of the euro to the dollar (presently $1.31/E) and other currencies is an average of the rates of the various national euros. As such, the euro today is far too strong for the peripheral countries. Were Italy, for example, to change back to Lira in place of euros, it would be a much devalued Lira that would greatly facilitate Italian exports while making imports from Germany, for instance, much more expensive. At the same time, the present euro is much weaker for Germany than would be any new deutsche mark that might replace it. Thus, German exports are being indirectly subsidized and stimulated and German imports inhibited by an artificially and systematically undervalued currency.

Of course, few in Germany recognize this and even fewer are willing to admit it publicly. At a recent meeting of Chinese and German leaders that I happened to attend in Shanghai, the Germans were robustly proud of their export virtuosity and competitiveness. They insisted that domestic austerity and export led growth were the keys to success and that other countries should imitate Germany, as they believe China has been doing. They argued that German export success is entirely due to the innovativeness and quality of German industry, and they insisted that Germany should not under any circumstances guarantee or take any responsibility for the debt and the health of the banking systems of other eurozone countries. Thus, in effect, they insisted on continuing to manipulate an undervalued German euro. Of course, they would all deny that that is what they are doing. But the denial doesn't change the facts.

Worse, is the fact that as a result of German leadership the whole eurozone is coming more and more to resemble Germany. Trade deficits are falling along with employment and imports while exports are rising somewhat.

The German trade surplus is now $245 billion or 6 percent of GDP. This is the largest surplus of any country despite the fact that Germany's GDP is only the world's fourth largest at about half the size of the Chinese GDP and a quarter that of the U.S. GDP (by comparison, China's trade surplus is about $217 billion). Now imagine that the whole eurozone reached the German surplus level of 6 percent

The global economy would come under severe strain if anything like this number materialized.

A few years ago I suggested that the solution to the eurozone crisis was for Germany to go back to the old D Mark. This would effectively have resulted in an upward revaluation of the German currency and would have automatically devalued the euro against the D Mark thereby allowing the peripheral eurozone countries to achieve growth and debt repayment without the crushing austerity that has now driven unemployment to record levels. Critics accused me of secretly wishing to undermine the euro. Of course, my suggestion was not adopted and the result now is that rather than the euro it is much of the eurozone itself that is being destroyed.