In the Grip *of* China's Bear Hug

Berlin's big gamble with Germany's economic future.

BY CRITON M. ZOAKOS

Germany is by far the most export-dependent among the world's major economies, much more so than either China or Japan. In 2008, Germany's exports were 47.2 percent of its GDP; the corresponding ratio for China was 33 percent and for Japan 17.5 percent.

In the course of 2010, this extraordinary export dependency of Germany has placed it in a position of unique vulnerability to the whims of China's policymakers. China has suddenly emerged as the fastest growing destination of German exports, with exports to China so far this year having grown by 54 percent. As shown in Figure 1, 2010 is the first time since China's emergence that Germany is running a surplus in its bilateral trade with China.

How abjectly dependent Germany has become on high export growth rates in order to achieve even modest GDP growth is shown in Figure 2. The graph shows that after the introduction of the common European currency, the euro, on January 1, 1999, the ratio of Germany's exports to GDP jumped from 24.8 percent in 1998 to 47.2 percent in 2008, illustrating how the eurozone is simply a captive market for German exports. In 2009, this ratio dropped to 40.6 percent as a result of the global crisis.

Notably, Germany's GDP growth rate in the post-1999 period following the euro's introduction remained sluggish despite the massive expansion of exports as a percent of GDP. In fact, during the period from 1999 to 2008, GDP growth averaged 1.49 percent—a rate much lower than the 2.53 percent growth of the preceding decade.

When in 2009 Germany's exports dropped by 22.6 percent, its GDP declined by 5 percent—despite massive countercyclical and stimulus government spending. During that time, Germany's exports-to-GDP ratio dropped to 40.6 percent from its all-time high of 47.2 percent. Its exports to the eurozone (the main captive market for German exports) declined by 22.1 percent and its exports to the United States declined by 28.6 percent.

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In defiance of the global pattern, however, Germany's 2009 exports to China increased by 2 percent, and a new era in Germany-China economic relations was launched.

German economic performance since the 1999 introduction of the euro demonstrates a crucial structural vulnerability: to achieve even modest GDP growth of less than 1 percent, Germany must achieve very high export growth rates—its domestic economy (private and government consumption and investment) having long ago lost the capacity to generate growth.

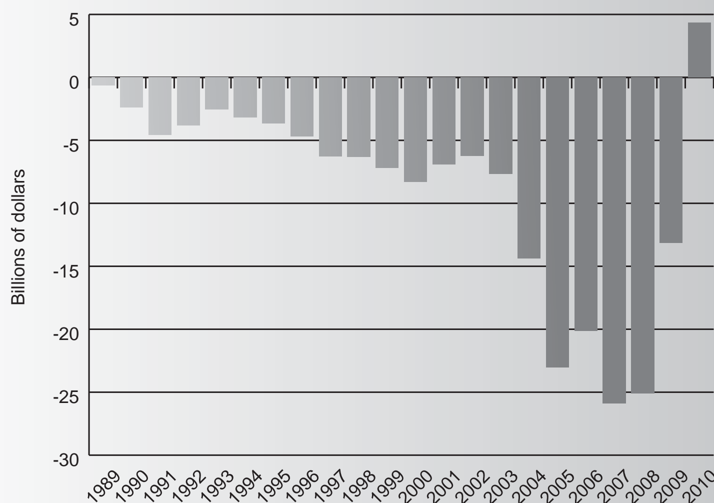
But in the aftermath of the 2008–09 crisis, the eurozone is no longer capable of providing German exports with the required margin of export growth. Exports to the eurozone in the first four months of 2010 were up by 11 percent from the corresponding period of 2009, and 24 percent below their corresponding 2008 level. Following April 2010, a series of massive austerity programs were implemented in response to the eurozone debt crisis that will have the effect of further undercutting German exports to its European partners. In short, exports to the eurozone are no longer a growth driver for Germany.

This has left China as the principal source of high growth for German exports, and consequently for German GDP.

Indeed, from January to August of 2010, Germany's exports to China have increased by 54 percent to $47.6 billion, resulting in a first-time-ever German bilateral surplus of $4.3 billion as shown in Figure 1.

Germany's exports have benefitted greatly—perhaps more than those of anyone else in the global economy—from China's unbridled government spending on infrastructure and lending to state-owned enterprises in the aftermath of the 2008 crisis. The bulk of Germany's exports to China have been technologically advanced manufacturing equipment, power generating turbines, state-of-the-art tunnel drilling machines, chemical plants, construction equipment, "green energy technology," advanced magnetic levitation trains, and the like.

China's principal purpose in buying these advanced technologies from Germany is to copy, reverse-engineer, and otherwise pilfer these advanced German technologies for the purpose of competing against Germany in the global markets.



Back in January of this year, a giddy radio commentator for the government-run Deutsche Welle radio network aired a puff piece celebrating this new German-Chinese trade relationship, noting with sarcastic glee that "Germany sells China the machines and equipment necessary to produce the consumer goods that people in the United States then buy on credit … [T]wo world champions … supported by the world leader in credit-based consumption, the United States of America."

The reality behind the hype is that Germany's new relationship with China suffers from two fatal flaws, either one of which is sufficient to put a sudden end to it.

The first is the folly of basing a long-term export surplus strategy on the

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assumption that the deficit importer will continue his "credit-based consumption."

The second flaw in the present German-Chinese arrangement is that China is buying Germany's "machines and equipment necessary to produce the consumer goods that people in the United States then buy on credit" only secondarily for the purpose of producing such consumer goods. China's principal purpose in buying these advanced technologies from Germany is to copy, reverse-engineer, and otherwise pilfer these advanced German technologies for the purpose of competing against Germany in the global markets.

Germany should have—but has not—learned from its experience within the eurozone that selling its exports as "credit-based consumption" in other countries invariably ends in disaster. The eurozone's growing sovereign debt crisis is the predictable result of deficit eurozone countries' buying of German export surpluses on credit. In an earlier *TIE* article, I showed how the entirety of Greece's sovereign debt is nothing but the sum of Greece's cumulative trade deficits from the time it joined the European Union to date. The same is generally the case with the sovereign debt of Spain, Italy, Portugal, and so forth.

In the end, the still-unresolved global financial crisis is the direct result of global trade imbalances, which the new German-Chinese trade relationship proposes to exacerbate. Germany's surpluses with China are financed from two sources: the Chinese government's unprecedented stimulus spending and fiat lending, and China's expanding surpluses with the United States. Neither of these will last long. China has decided that it cannot repeat the promiscuous spending spree of 2009–10, and political developments in the United States are careening toward retaliatory legislative action against Chinese surpluses.

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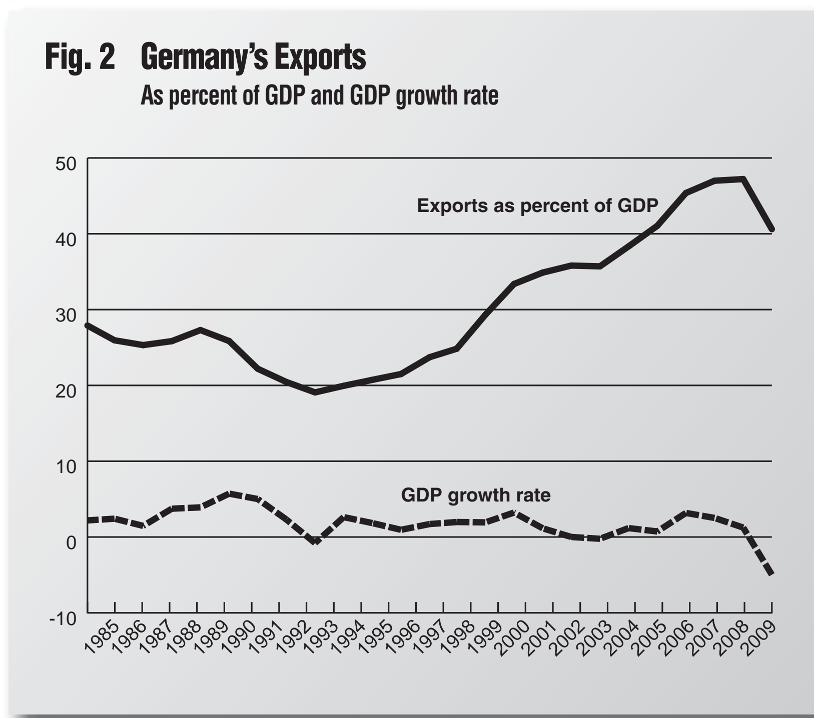

The second flaw in the new German-Chinese arrangement—China's resolute stealing of the advanced German technologies that it imports—confronts corporate Germany with an existential dilemma. If Germany continues to surrender to China its technological competitive advantage, China will be able over the next five years to push Germany out of those global markets where Germany is currently dominant, as is already happening in the global solar cell market and as is being attempted in the magnetic levitation trains market.

If, on the other hand, corporate Germany decides to protect its technological competitive advantage and refuses to sell to China on China's technology-pilfering terms, then the prodigious German export machine will be threatened with near-term collapse. ◆