

Globalization and the German Economy

Effect of Globalisation on the German Economy

Liberalization of markets is the most important prerequisite for the process of Globalisation. In fact, liberalization has the capacity to increase countries wealth more than development aid. Once developing countries like South-Korea, Taiwan, Singapore and Hong Kong for example became the so-called economically successful Asian "Tiger states" of the 1980s. In Europe, Ireland is a similar example for such a lucrative development. In order to integrate more markets and production locations worldwide, world trade has to be further liberalized. The WTO has to be strengthened, trade barriers and obstacles to the liberalization of the service sector have to be removed and the agricultural market has to be opened.

Globalization represents an intensified division of labour and an integration of domestic markets across boundaries. In the period 1985 to 2004 the value of world exports of goods increased on average by 8 per cent annually, the global output by 2.8 per cent. Even stronger than the value of world exports of goods was the increase of the value of the world exports of services with 8.8 per cent annually, in absolute numbers from 407 bn USD 1985 to 2193 bn USD 2004.

Germany is benefiting particularly from the process of globalisation. Exports now account for 45 per cent of economic output. Between 2000 and 2005 its share in global trade averaged 9.7 per cent for goods, and 7.5 per cent for services.

Increasing competition – new challenges for politics and companies

Globalisation is increasing global competition between companies and locations. Increasingly, companies are operating and competing with each other in world markets. The attractions of a location help determine the level of investment, growth and employment. For a long time, Germany was not optimally placed for this competition. The long period of stagnation and decline in investment lasted until 2006. In that year, German net investment

was 3.8 per cent, putting Germany next to last in a comparison of OECD countries. While German companies again increased investment in plant and machinery in 2007 – by around 11 per cent compared with the previous year – public sector investment rose again for the first time after years of stagnation. Direct investment is the

most dynamic element in globalisation. It increased from USD 13 billion in 1970 to USD 1,500 billion in 2007. Between 1985 and 2004, it grew by an annual average of 14 per cent. Between 1995 and 2005, companies from all over the world invested almost USD 430 billion in Germany, the fifth largest inflow of direct investment in the world. At the same time, German companies utilised political developments (EU eastern expansion) and technological developments (new

ITCs) to open up locations all over the world and enhance their competitiveness.

Analysis of the direct investment statistics of Deutsche Bundesbank for 1996 to 2004 shows that German direct investment abroad increased domestic employment on

balance. This makes demands to limit cross-border activities of multinational companies – currently being debated in my own country, for example – all the more incomprehensible.

Offshoring increased employment on balance, in line with increased flexibility in the labour market and employees. Advancing liberalisation of the capital markets has significantly facilitated financing cross-border activities. Trading in and the total stock of listed bonds

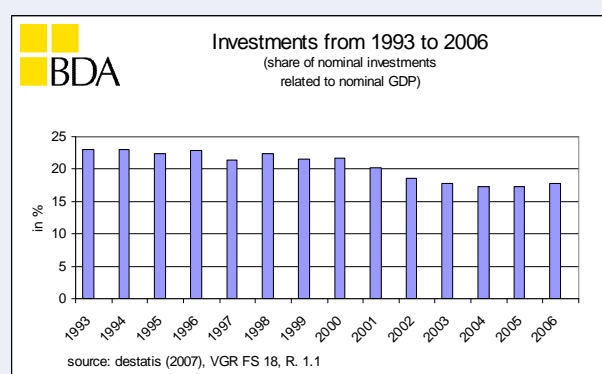
rose roughly fourfold between 1990 and 2005. According to Private Equity Intelligence, private equity totalling EUR 380 billion was acquired and invested in 2006 alone. This gave additional vigour to globalisation. The first address for private equity investment in Europe was again the UK, with a share of 33 per cent of all European PE investment, followed by France (15.2 per cent) and Germany (10.2 per cent).

Germany's third place position leaves on thing very clear – because of the high tax burden, hardly any equity investment funds are locating there. Despite the growth in importance of the PE industry, the German investment

Exports are rapidly increasing



Investments on a low level



market is significantly lagging behind many other European competitors, and particularly the USA. There is still no sign of harmonised private equity legislation including provisions for buy-outs as the biggest sector and also broad areas of growth and expansion financing, although this is urgently needed.

Improving conditions for locations

Politicians have recognised one opportunity for improving conditions at national level by reducing the tax burden for companies. Company tax reform has lowered the nominal total tax burden on companies as at January 1 2008 from around 39 per cent to around 30 per cent. This puts Germany nicely in the middle of the European league table. The situation with profits is still not satisfactory, with German companies in the lower third in international comparisons in 2005. However, according to the corporate accounts statistics of Deutsche Bundesbank, earnings improved significantly in 2006. It is too early to say whether this is due to economic growth, or whether German companies are catching up with other countries on a lasting basis.

This review shows two things – Germany is a beneficiary of globalisation, but is failing to take full advantage of its opportunities. The problem here is not the companies, so much as the location itself. Clearly, there is need for improvement in shaping the economic conditions, which is a core responsibility of government. In addition, the social benefits – which have so far passed largely unnoticed – need to be emphasised more strongly to the general public, in order to increase acceptance of the needs for globalisation.

Make use of globalisation – overcoming barriers

Globalisation is having a different impact on different industrialised nations. Countries like the UK which are taking an aggressive approach to the economic and social challenges are prospering more than countries like Germany and France which are trying to regulate globalisation. This discrepancy in dealing with a trend which is not only unstoppable but which we should not even be trying to hinder is due to the frequently distorted and one-sided perception by the German public. For example, globalisation is not given credit for the benefits to companies and consumers. German public opinion typically associates globalisation with cuts in employment and offshoring. Positive benefits, such as

- higher productivity,
- improved competitiveness,
- greater funding for research and development,

- more innovation and investment, and
- less freedom in price setting,

which reduces the purchasing prices for companies, remain largely unrecognised. Households as consumers also benefit from the positive welfare effects of globalisation through

- inexpensive products,
- greater product diversity and incomes.

Ultimately, the entire national economy benefits from the side effects of globalisation. Growth and employment are boosted. Technological progress is increasingly being passed on in the form of lower product prices. This reduces the scope for wage increases. For employers and unions, globalisation means a need for a paradigm shift.

Decreasing scope for redistribution and growing competition in labour markets is leading to the need for greater differentiation in wages. Wage policy needs to take this into account, in the form of greater decentralisation. Relative wage rigidity leads to loss of employment. The greater intensity of competition particularly affects less qualified workers with lower productivity. To find work, they need a low-wage sector. This is being almost entirely overlooked in the current debate on minimum wages.

Globalisation creates jobs – denial costs jobs

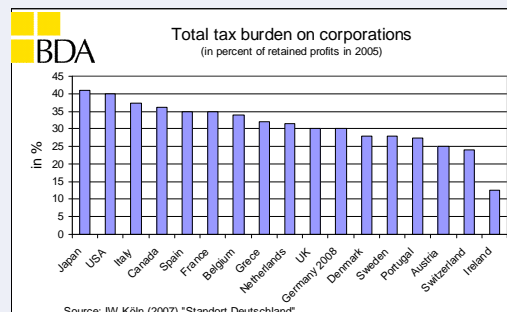
The fact that German products can be sold in world markets despite the high level of labour costs is also due to the fact that companies are purchasing raw materials and intermediates abroad at favourable prices. Since 1995 the foreign share in added value of German exports has grown significantly. In 2006, German exports of goods had a 44.8 per cent share of foreign value added, compared with 40.1 per cent in 2000 and only 31.1 per cent in 1995. At the same time, the gross added value generated by exports rose faster

than gross added value in the economy as a whole – in 1995, exports generated 16 per cent of domestic gross added value, increasing to around 20 per cent in 2000 and 23 per cent in 2006. At the bottom line, this network economy creates new jobs, rather than destroying them. In industries which benefited particularly from globalisation, employment rose between 1991 and 2005.

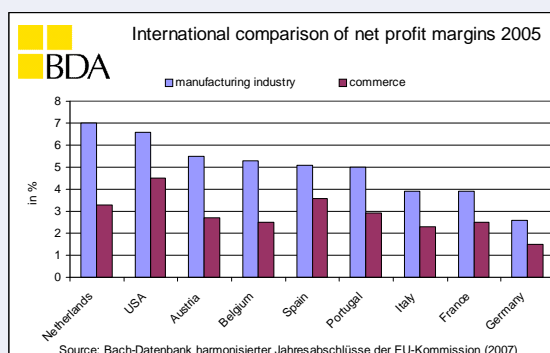
Often, companies are able to secure domestic employment to a great extent by offshoring specific areas of production and utilising increased possibilities for mixed costing from globally operating locations. According to a 2007 German Chambers of Industry and Commerce (DIHK) study, cost savings were the decisive motivation for 30 per cent of the companies investing abroad.

Improving operation of the labour market

Germany's tax burden is too high



Poor profit performance



The structural transformation associated with globalisation calls for increased flexibility in the labour market. Despite record levels of employment, Germany has yet to succeed in creating new jobs to replace those lost. One reason is the rigidity in labour market regulation. Despite some progress, such as increased part-time work, this still poses an obstacle to hiring, particularly for small and medium-sized companies. The main sufferers from this are unskilled workers, which are particularly affected by competition from low-wage countries. The goal must be to create new openings for unskilled job seekers, for example in personal and domestic services.

Blocking a minimum wage

A minimum wage not only does not help here, it actually reduces the opportunities. If wages for unskilled labour are set above the individual productivity, jobs are lost, and no new ones are created. This is why it is useful to distinguish between the impact of wages on costs and in incomes. The various models of combined income seek to do this. Greater individual benefits compared with straight transfer payments are also matched by greater added value in the economy as a whole.

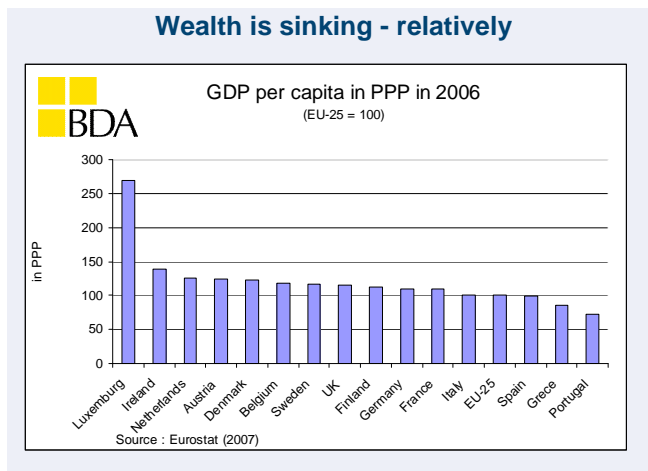
Increase investment in human capital

Investment in education increases the human capital of an economy. The OECD PISA study shows that Germany needs to increase its efforts in this area. German companies were already reporting substantial problems in recruiting engineers in 2006. One company in six employing engineers was facing these problems.

of the lack of applicants. The macroeconomic consequences of this lack of human capital with its relevance to innovation are serious. As a direct result of the shortage of engineers, the German economy lost added value totaling at least EUR 3.48 billion last year. One of the main reasons for the shortage of engineers is that international comparisons show that Germany has too few students enrolled in natural sciences and particularly engineering courses. The high drop-out rate compared with other courses and the low percentage of women are further exacerbating the situation.

Persuading policy-makers to rethink

Free movement of goods, services and capital and an improved entrepreneurial environment make possible welfare benefits for all involved. In Germany, policy makers are not giving adequate consideration to the needs for adjustment to globalisation. Too often, innovative and growth-promoting ideas are dismissed for ideological reasons (e.g. Genetic Engineering Act, use of nuclear energy) or there is a lack of political determination (e.g. deregulating the labour market, delay in reducing red tape, inadequate reforms in the federal structure). Here, the politicians need to become more open and provide strong guidance.



Globalization creates jobs

Production branch	1995	2000	2005
Automobiles and automobile parts	575.000	691.000	706.000
Plastic goods	299.000	397.000	383.000
Secondary raw material	12.000	18.000	22.000

Source: Federal Statistical Office of Germany (2007)

Publication

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Almost all governments in developed economies appear to subscribe to the view that future economic prosperity and the maintenance of skilled employment depends on a country's ability to attract and retain high value added industries. Increasingly, countries like Germany are competing with each other to secure these industries and governments are inevitably being drawn into the process.

BDA Contact

Dr. Hans-Jürgen Völz
Tel. +49 30 2033-1950

Confederation of German Employers' Associations
House of German Business
Breite Straße 29
10178 Berlin
GERMANY

The BDA in the WWW

www.arbeitgeber.de