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Germany's International Competitiveness

*Germany's merits as a business location are being increasingly questioned.
Is the competitiveness of the German economy actually in jeopardy?
How could possible weaknesses be rectified?*

Erhard Kantzenbach*

Germany as a Business Location

In Germany hardly any issue has been more prominent in the economic debate in recent months than that of the international competitiveness of the German economy, or the question of Germany's attractiveness as a business location, which in my opinion comes down to the same thing. Do not high wages and non-wage labour costs, high taxation and the high level of state regulation place German companies at too great a disadvantage in international competition? There are fears that for these reasons an increasing number of firms in Germany will have to close or move abroad and that Germany will become less attractive for international investors. Is not the steady advance of companies from the Far East into our markets in high-technology products a sign that Germany has lost its lead in technological competition?

These issues are certainly not new; they have been discussed in one form or another in Germany since the mid-seventies, when the collapse of the Bretton Woods world monetary system and the dramatic increase in oil prices caused a fundamental change in competitive relationships in the world economy. However, I believe there are three main reasons why these questions are being raised again now with particular concern.

Concern about Competitiveness

First, after a long period of steady growth, our economy has been in the throes of a steep recession since the middle of last year. We must expect real gross national

product to contract in 1993 for the first time in ten years. It is difficult to predict when the upturn in the economy will come; according to the autumn assessment by the economic research institutes, it will probably not begin until the spring of 1994.¹

For most enterprises, a recession means a fall in sales, increased competitive pressure and falling profits or even losses. Structural weaknesses that had been masked during the good times now come to light and have to be rectified. For the individual businessman, it is often impossible to distinguish between a temporary, cyclical downturn and a permanent, structural change.

Secondly, the question as to the international competitiveness of the German economy arises partly as a result of the extraordinary strains caused by German unification. The initial, widely-held belief that all we had to do in the former GDR was to sweep away the constraints of the command economy and eliminate supply bottlenecks in order to trigger self-sustaining economic growth has been bitterly disappointed.² Instead of a one-off injection of finance to kick-start the economy in the new Länder, we must be prepared to make on-going capital transfers of between DM 150 and 200 billion a year for many years. Even if the Government manages to make significant

¹ See "Die Lage der Weltwirtschaft und der deutschen Wirtschaft im Herbst 1993", Essen, 21st October 1993.

² Erhard Kantzenbach: Wirtschaftspolitische Probleme der deutschen Wiedervereinigung. Berichte aus den Sitzungen der Joachim Jungius Gesellschaft der Wissenschaften e.V., Vol. 11, No. 3, Hamburg 1993.

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savings in public expenditure, the German economy will not be able to avoid further tax increases, at the very latest when it emerges from the present recession. It is therefore all the more urgent to take a critical look at the international competitiveness of the German economy and to strengthen it by means of a rational economic policy.

It is precisely the rationality and effectiveness of our economic policy that have increasingly been questioned in recent months, however. This is the third reason why concern about Germany's international competitiveness has increased.³ There is a growing impression that necessary economic policy decisions can no longer be taken in the face of opposition from sectional interests. This applies in particular to the constant toing and froing about tax increases to finance reunification; it applies to the reduction in subsidies and tax concessions, which is repeatedly being announced but never implemented; and it even applies increasingly to the enforcement of the laws upon which our economic system reposes. The state's failure to act encourages opportunism and rent-seeking among the population at large, instead of economic performance. It impairs the efficiency of our economy, and hence its international competitiveness as well.

These fears will be examined in rather more detail below, in three stages.

First, I think it is necessary to define what the concepts of locational quality and international competitiveness mean for an economy as a whole, as they derive originally from microeconomic considerations. This will also automatically specify the objective that economic policy should pursue in this connection.

Secondly, I shall attempt to determine the current position of the German economy in international competition and to forecast how it will develop in future. In this connection I will also examine briefly the main determinants of international competitiveness.

Finally, I shall comment briefly on the economic policy measures I believe are necessary in the present situation in order to maintain and improve Germany's quality as an internationally competitive location over the long term.

Definition of Terms

When applied to the individual firm, the term "international competitiveness" implies that the firm is active in foreign or international markets and can compete successfully with other suppliers in those markets. Its competitiveness will be judged to be all the greater, the

more rapidly it grows in relation to its competitors. Superior competitiveness manifests itself in growing market shares and the successful penetration of new markets. Since a firm can achieve long-term expansion only if it makes satisfactory profits, and, conversely, since it has to expand if it is to maximise its profits over the long term, there is no conflict in the long run between the profit and growth objectives.

It is much more difficult, however, to interpret the concept of international competitiveness plausibly for an economy as a whole. At first sight it seems logical to draw an analogy with the microeconomic situation; viewed in these terms, an economy would be described as particularly competitive if its firms were internationally successful and gained growing market shares.

Hence, in macroeconomic terms rising exports and falling imports, in other words a rising current account surplus, would be a sign of increasing competitiveness. Indeed, this interpretation is frequently encountered in economic literature, especially in short-term cyclical analyses. In a situation of cyclical underemployment a rising export surplus is thoroughly desirable; it can boost output and employment and hence increase per capita incomes.

From a long-term perspective, however, this approach is misleading, especially if the concept of international competitiveness is bound up with economic policy objectives, as is generally the case when the present issue is under discussion.

Significance of Export Surpluses

First, an export surplus means that a corresponding portion of the goods and services produced in the country is not available for domestic consumption or domestic investment. There is a corresponding net capital outflow in the form of direct investment abroad or the purchase of foreign debt or equity. This is often interpreted as a reflection of weak domestic investment and the consequence of unfavourable locational conditions, but foreign investment can also be used to secure sources of supply and sales outlets and to that extent can strengthen the position of domestic firms in international competition. Hence, a large export surplus and a corresponding net capital outflow alone tell us nothing about the competitiveness of the economy in question. This requires a more detailed analysis.

One country's export surpluses necessarily mean import surpluses for its trading partners, either directly or indirectly. If these are associated with permanent underemployment in the partner countries, they may

³ Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung: Jahresgutachten 1993/94, pp. 163 ff.

trigger reactions on the trade front. Despite existing free-trade obligations, an attempt will be made to curb imports. Safeguard clauses, anti-dumping measures and "voluntary" restraint agreements offer many and varied ways of doing this. It cannot be in a country's economic interest to provoke measures of this kind by running up extreme current account surpluses.

On the other hand, there are economic mechanisms that operate to reduce extreme trade imbalances. In a system of fixed exchange rates, current account surpluses tend to lead to an expansion in the domestic money supply and hence to price increases. In a system of flexible exchange rates they tend to cause the currency to appreciate. Both of these tendencies are generally reinforced by speculative short-term capital movements. They dampen exports and encourage imports, in other words they work in favour of current account equilibrium.

Conversely, a large import surplus can lead to depreciation of the currency in question, giving fresh impetus to exports. In my view, it would be misleading to describe these repercussions of changed price or exchange rate relationships as an improvement or deterioration in international competitiveness.

These considerations therefore lead one to conclude that only when viewed over the short term can a country's export surplus possibly serve as a measure of its international competitiveness. From the long-term perspective, which should form the basis of the country's industrial and trade policy, it proves to be an inappropriate indicator. Economic policy should aim to achieve a trade surplus to the extent that it is needed to finance an autonomous long-term capital outflow. Hence, it is not the trade balance that should be used as a measure of a country's international competitiveness but the composition of its foreign trade. The remarks that follow are therefore based on the assumption of a neutral current account and macroeconomic equilibrium in the sense used in Germany's Law to Promote Stability and Growth of the Economy.

Findings of Foreign Trade Theory

The ultimate objective of government economic policy should be the economic prosperity of the country's citizens, measured in terms of real per capita gross national product. Obviously, this aggregate cannot encapsulate all the connotations of the concept of prosperity. In particular, it cannot take account of the desire for greater leisure, more protection of the natural environment and more socially equitable income distribution. All of these objectives enjoy high priority, and specific economic policy instruments are used to achieve

them, but they are not an objective of government industrial and trade policy. They will therefore be disregarded in the remarks that follow.

The question of which trade measures can be used to improve the prosperity of the population has always been the favourite subject of foreign trade theory. The classical free trade theorem postulated that the three classical factors of production – namely labour, land and capital – were unevenly distributed among countries and concluded that free trade made it possible for participating countries to specialise on the basis of comparative cost advantages, which brought benefits for them all. The so-called comparative costs theory and its further refinement in the Heckscher-Ohlin theorem not only represent outstanding achievements in the field of economic theory, their premises also corresponded closely to the reality of their time.

Modern foreign trade theory has retained the basic classical paradigm, but it has adapted the theory's premises to suit current real economic conditions and the findings of more recent empirical research. For example, it takes account of widespread economies of scale and quality differentiation in industrial production. For our purposes, two other aspects are also of particular importance:

- first the recognition that the quality of the input of labour – the so-called human capital – is of paramount importance for productivity gains and economic growth, and
- secondly, acknowledgement of the fact that capital is no longer tied to a particular country but is largely free of restrictions on its international mobility.

Hence, modern foreign trade theory no longer explains trade between industrial and developing countries in terms of the difference in the availability of labour and capital. In contrast to labour, capital is highly mobile and hence available in almost unlimited quantities if yield expectations are favourable and risk low. Trade flows are determined by differences in the availability of highly skilled labour, in other words human capital. It is abundant in the highly developed industrial countries, and scarce in the developing countries.

The relative strength of the industrial countries therefore lies in the development, production and export of new, technically demanding products. Their temporary monopoly in these goods generates high profits and enables them to pay high wages.

Once these products reach technical maturity, they can be produced and exported more cheaply by the less developed countries using imported capital and cheap

domestic labour. The intensive price competition that then develops limits the profits to be made and curbs wages.

Hence, if the industrial countries want to maintain their high wage levels, they must constantly develop and market new and improved products. Their high costs make it impossible for them to defend their mature older products in the face of price competition from the low-wage countries.

Accordingly, the European industrial countries and the USA lost their competitive lead in cameras, radios, cars, ships and bulk steel first to Japan and then to the newly industrialising countries of East Asia. For the firms and industries concerned, this undoubtedly means a loss in international competitiveness; Germany is no longer an optimum location for them.

The same does not apply, however, to the economies in question as a whole. In the meantime they have developed new exportable products in aviation and space technology, EDP, pharmaceuticals, nuclear technology, and so forth. If they succeed in creating in these industries new, more productive jobs for the workers released by their mature industries, they will be able to continue to increase per capita incomes. They will be able to maintain their lead over the less developed countries, and their international competitiveness will be unaffected.

Conclusions for Economic Policy

On the basis of these considerations, some conclusions can already be drawn for economic policy, the objective of which is to maximise the incomes of the domestic population over the long term. There are two possible ways of achieving this.

□ First, economic policy should aim to attract additional foreign capital by improving the conditions for investment within the country. It is not primarily a question of raising the capital intensity of the economy, although this alone would improve labour productivity and hence raise the level of incomes. Much more important, in my view, is the acceleration in technical progress and structural change associated with a rising volume of investment. High net investment makes it possible to modernise the capital stock rapidly and to adjust it to changed demand conditions.

□ Secondly, economic policy should increase the supply of highly skilled labour in the economy by promoting basic research and scientific training. In theoretical terms, the combination of more human capital with the available labour force potential also leads to an increase in labour productivity and incomes.

Each of these measures, namely the attraction of investment capital and the formation of human capital, conditions the effectiveness of the other. In order for new scientific knowledge to be used productively, additional capital is needed for investment in new production plant. However, the high yields needed to attract capital can be achieved mainly by means of product and process innovation. For industrial countries short of land and natural resources, the combined use of both factors represents the only long-term strategy for maintaining and improving their international competitiveness. From this follows the question of how successful Germany has been so far in applying this economic policy.

The Hamburg Institute for Economic Research (HWWA) recently produced a report for the Friedrich Ebert Foundation on the impact of reunification on Germany as an industrial location.⁴ It first analysed Germany's strengths and weaknesses before reunification on the basis of the available statistical material and the results of business surveys. The likely effects of reunification then had to be estimated for lack of more recent statistics. It is not possible to present the report's conclusions in detail here, but only to summarise its main findings. To my mind, one of the particularly interesting aspects relates to the quality of Germany as a location by comparison with the USA and Japan.

Statistical Indicators

Let us begin by comparing per capita income, which serves as a measure of an economy's international competitiveness and as the final operational objective of government industrial and trade policy. Since actual exchange rates are not suitable for use as conversion factors, either because they fluctuate sharply or because they are fixed within the European Monetary System, the Statistical Office of the European Communities has made conversions on the basis of purchasing power comparisons.

According to these statistics, Germany was in the lead among the four largest EC countries up to 1989, ahead of France, the United Kingdom and Italy. However, the corresponding figures for the USA were significantly higher. Until 1986 Japan was ahead of France but behind Western Germany; according to these statistics, it overtook Western Germany after 1988. According to a new set of statistics released by Eurostat after the publication

⁴ Michael Krakowski, Dirk Lau and Andreas Lux: Auswirkungen der Wiedervereinigung auf den Industriestandort Deutschland, Friedrich-Ebert-Stiftung, Wirtschaftspolitische Diskurse, No. 32, Bonn 1992; Krakowski, Lau and Lux: Auswirkungen der Wiedervereinigung auf die Standortqualität Westdeutschlands, in: Wirtschaftsdienst, Vol. 72 (1992), No. 9, pp. 464 ff.; Krakowski, Lau and Lux: East Germany's Quality as a Business Location, in: INTERECONOMICS, Vol. 28 (1993), No. 1, pp. 16 ff.

of the HWWA report Japan had still not overtaken Western Germany in 1990.

The figures show some interesting findings:

- first, Western Germany was able to maintain a leading position among the industrial countries, at least until reunification. Hence, the sum total of the locational factors cannot have been bad up until that time. However, this does not give an "all clear" for the future, nor does it mean that significant further improvements cannot be made in individual locational factors;
- secondly, the USA was also able to maintain its absolute lead. This gives the lie to the opposite impression that is sometimes created by statistical comparisons based on exchange rates. Even the notorious pockets of poverty in the USA are the result of greater inequality of distribution, not a lower level of incomes;
- thirdly, Japan's spectacular success in the export of high-tech goods is clearly not confined to just one part of the economy and the result of a selective industrial strategy. Rather, Japan is one of the leading group of industrial countries on account of its above-average general rate of economic growth, and now also its standard of living.

The rate of incomes growth – or more precisely the rate of growth in real per capita income – is an even more significant indicator of an economy's international competitiveness than the level of incomes. Taking the average for the years from 1979 to 1991, Western Germany occupies a good middle position in Europe, with a growth rate of 1.8%. Italy is higher, with one of 2.1%, and the United Kingdom and France lower, with rates of 1.6 and 1.5% respectively. Incomes growth was much faster in

Japan, however, at 3.6%, and much lower in the USA, at 0.9%.

Within the so-called triad, Japan therefore increased considerably in importance over this period and the USA slipped backwards.

Selected Locational Factors

The investment ratio is a measure of the attractiveness of an industrial location. Only investment allows new jobs to be created and existing ones to be updated. Investment is therefore the precondition for economic growth and rising incomes. The investment ratio – that is to say, the ratio of gross capital formation to gross domestic product – barely changed in the leading industrial countries between 1979 and 1989, but there are considerable differences between countries. Here too, Germany, France and Italy are in the middle range with a ratio of between 20 and 22%. Japan has a far higher ratio of about 30%, while the United Kingdom and the USA have significantly lower ratios of between 16 and 18%.

The above-mentioned HWWA report examines a series of factors that influence the profitability of investments. It would take too long to list them all here, but firms repeatedly point especially to high unit labour costs, high taxation and the high degree of regulation, for example in the labour market and in environmental protection.

The only one of these factors for which internationally comparable figures are available is unit labour costs. In Germany they rose by 37% between 1979 and 1989, but developments in the other industrial countries were similar. As far as competitiveness is concerned, the decisive aspect is therefore the size of the increase in relation to competitor countries. According to a calculation

Erhard Kantzenbach/Hans-Eckart Scharrer/Leonard Waverman (Eds.) Competition Policy in an Interdependent World Economy

Nationale Wettbewerbspolitik sieht sich zunehmend Beschränkungen durch die wachsende weltwirtschaftliche Verflechtung ausgesetzt. Zugleich muß sie eine neue Rolle im Dreieck mit der Industrie- und der Handelspolitik finden. Dabei entfaltet sie häufig grenzüberschreitende Wirkungen und gerät so in Konflikt mit den Interessen anderer Staaten. Die „atlantische“ Dimension dieser Problematik war Gegenstand einer Konferenz führender deutscher und kanadischer Experten aus Forschungsinstituten, Universitäten und Kartellbehörden. Die 13 Beiträge sind in diesem Band vereint. Er gliedert sich in vier Teile:

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- empirische Zusammenhänge zwischen Unternehmenskonzentration, Industriepolitik und Innovationsprozeß;
- Ansätze einer internationalen Koordinierung der Wettbewerbspolitik.

Das Buch wendet sich an alle, die sich mit Fragen der Wettbewerbspolitik und der internationalen Wirtschaft aus juristischer, ökonomischer und wirtschaftspolitischer Sicht befassen.

1993, 314 S., broch., 75,- DM, ISBN 3-7890-3062-7
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by the EC Commission, relative unit labour costs in Germany rose by 8%, so that they contributed to a deterioration in the international competitiveness of the German economy. This trend continued between 1990 and 1992.

In theory, rising relative unit labour costs could have been offset by rising prices and a fall in the exchange rate of the Deutsche Mark. In reality, however, this did not occur. In recent years wage developments have therefore contributed to a deterioration in our competitiveness; this is particularly true of the 1992 wage round, although not the 1993 round.

A precise international comparison is not possible as far as taxation is concerned, as the division of tasks between the private and public sectors differs markedly from one industrial country to another. For example, the companies polled in a survey carried out by the Ifo Institute in 1988 cited high taxation in Germany as a locational disadvantage.⁵ At the same time, however, the well developed infrastructure and high level of training of the workforce, which could not have been achieved without high government expenditure, were mentioned as being positive locational factors. It is reasonable to assume a similar correlation between the high degree of regulation of the German labour markets – at least by comparison with the USA – and the high degree of political and economic stability, which finds expression in an extremely low frequency of strikes, for example.

These few examples show how little value there is in focusing on individual locational factors in isolation if it is not possible to estimate the indirect consequences precisely.

Weaknesses in State-of-the-Art Technology

The importance of the composition of trade for the international competitiveness of an economy cannot be emphasised enough, as countries with little in the way of raw materials can achieve high per capita incomes only by exporting innovative goods with a high input of human capital. The annual publications of the German Federal Ministry for Research and Technology on the technological competitiveness of German industry⁶ are very informative in this regard.

These reports divide goods with a high research and development content into two groups: goods incorporating advanced technology and those embodying "state-of-the-art" technology. The first group is defined as goods in which research expenditure amounts to between 3.5 and 8.5% of turnover, while the second group entails R and D of

more than 8.5%. The 1990 report gives the ratio of exports to imports for the various product groups.

The figures show Germany to be one of the leading industrial countries in the technology field, but they also reveal significant weaknesses in state-of-the-art technology by comparison with the USA and especially Japan.

Overall, Western Germany's exports of R and D-intensive goods were twice as large as its imports in 1988, in other words its export-import index was about 200. The index for state-of-the-art technology, however, was only 126 while that for advanced technology goods was 248.

If trade is broken down on a regional basis, the index for exports and imports of all R and D-intensive goods was highest in relation to Eastern Europe, at 818. Then followed the EC with 201, the USA with 171 and South-East Asia (excluding Japan) with 120. In relation to Japan, however, exports amounted to only 41% of imports. In other words, in relation to all regions except Japan, Germany achieved a substantial export surplus in R and D-intensive goods.

The picture with regard to state-of-the-art technology goods is very different, however. Here Germany achieved a substantial export surplus only in relation to Eastern Europe, with an export-import index of 444. Trade with the other EC countries was in balance, as the index of 99 indicates. The index figures for trade with the other regions were 72 vis-à-vis South-East Asia, 61 vis-à-vis the USA and only 25 vis-à-vis Japan.

In state-of-the-art technology, Germany, and the EC as a whole, therefore lags behind the two other poles of attraction in the world economy, namely North America and East Asia. Germany's strong competitive position in world trade depends predominantly on so-called advanced technology. This specialisation in technology that is no longer the very latest creates a risk that Germany will fall further behind in technological competition. In any event, considerable efforts in research and development will be needed if Germany is to maintain its leading position in the per capita income table.

What economic policy conclusions are to be drawn from this analysis? Let us begin with the last of the problems I have outlined, namely Europe's obvious inferiority in various types of state-of-the-art technology by comparison with Japan and the USA, which has triggered a common policy objective in the European Community.⁷ The French in particular, but also the Italians and other

⁵ Ifo-Schnelldienst, No. 4/1989.

⁶ Bundesministerium für Forschung und Technologie: Zur technologischen Wettbewerbsfähigkeit der deutschen Industrie, Presse-dokumentation No. 4/1990.

Southern Europeans, are calling for a systematic sectoral industrial and trade policy at Community level, aimed at promoting research and development and the worldwide marketing of certain technology-intensive products.

The problem here is that it is very difficult to identify, *ex ante*, which industries are promising and hence worthy of official support. In addition, it is likely that other countries would adopt similar tactics, leading to an outright subsidies war. The German Monopolies Commission set out the counterarguments in detail in its latest biennial report.⁸

Necessary State Measures

Certain actions are, however, urgently needed. First of these is a new initiative in research and training policy. It is true that Germany is roughly on a par with Japan and the USA and ahead of France, the United Kingdom and Italy in terms of the ratio of total R and D expenditure to GDP, but this ranking is attributable primarily to relatively high expenditure by the private sector.

In terms of R and D expenditure in the public training sector, Germany comes last of these five industrial countries. Contrary to widely held belief, Germany clearly has ground to make up in publicly financed basic research and academic training.⁹

The plight of our universities is not due exclusively or primarily to underfunding, however. A far more important factor is the need for structural reforms, such as those that have been discussed for decades but rarely implemented. Nevertheless, it is true that cost-cutting has now reached such a scale that it is beginning to cut into the very fabric of the system. There is reason to fear that in so doing Germany is seriously jeopardising its long-term prospects in international technological and economic competition.

Mistaken Policy of Subsidisation

Secondly, there is the debate within the European Community about a future technology and industrial policy. We Germans, especially politicians and academics, always like to portray ourselves as models of rectitude in this respect, invoking market principles and

vehemently rejecting intervention in favour of particular sectors.

Unfortunately, we are not quite so true to our principles in practice. For example, the German Institute for Economic Research reported in November 1992¹⁰ that financial aid from the Federal Government rose by an average of 6% a year between 1986 and 1992. These figures relate solely to the old Länder. In 1992 such aid totalled DM 53.5 billion. The largest recipients of subsidies were agriculture, with DM 15.3 billion, coal mining with DM 8.3 billion and the railways with DM 7.4 billion. Electronics and the aircraft and aerospace sector, which have a relatively high research intensity, received only DM 1.9 and 1.4 billion respectively.

Important reasons relating to the requirements of the free market system generally militate against subsidising particular industries. Moreover, the fact that subsidies are so clearly concentrated on contracting industries, such as agriculture and coal mining, is particularly damaging to the competitiveness of the German economy. Incomes and employment in these sectors are protected against market forces for social reasons. Production factors are being kept in unproductive uses, whereas they could generate higher output in growing industries. It cannot be denied that the redeployment of labour runs up against serious mobility constraints and must therefore be cushioned by the state, but subsidies should be subject to stronger quantitative restrictions and time limits than in the past in order to encourage, rather than impede, the structural adjustment of the economy to international competitive conditions.

Return to a Policy of Stability

Thirdly, there is an urgent need for a return to a sound and credible policy for stability and growth. Most politicians and academics grossly underestimated the consequences that the introduction of the economic and monetary union would have on the former GDR. Too much faith was placed in the spontaneous growth effects of emerging markets. Accordingly, the scale of transfer payments needed was also seriously underestimated. It was thought we could get away with providing short-term financial support to kick-start the economy. This was to be financed by borrowing, which would be serviced and repaid out of the expected growth in tax revenue.

When the expected surge in economic activity failed to materialise, the fuse was lit under the burgeoning government borrowing. As has already been pointed out in the past,¹¹ it would have been advisable to finance the

⁷ See Zeitgespräch: Welche Technologiepolitik braucht der Standort Deutschland?, with contributions by Frieder Meyer-Krahmer, Erich Staudt and Dietmar Keller/Christoph Kreienbaum, in: Wirtschaftsdienst, Vol. 73 (1993), No. 11, pp. 559 ff.

⁸ Monopolkommission, Hauptgutachten 1990/91, Chapter VII, Competition and strategic trade policy, Baden-Baden 1992.

⁹ R and D expenditure by the private sector has been growing significantly more slowly since 1989 than it did during the eighties, while that of the Federal Ministry for Research and Technology has been declining per capita. Cf. Frieder Meyer-Krahmer: Elemente einer künftigen Technologiepolitik, in: Wirtschaftsdienst, Vol. 73 (1993), No. 11, pp. 559 ff.

¹⁰ DIW-Wochenbericht No. 46/92.

¹¹ Erhard Kantzenbach, op. cit.

transfer payments by raising taxes as early as the winter of 1990-91:

- ☐ it was advisable on cyclical grounds, as the economy was then booming;
- ☐ it was advisable on growth policy grounds, as the transfer payments were being used mainly for consumption, and
- ☐ in my opinion it was advisable for these reasons even on constitutional grounds under Article 115 of the Basic Law.

The consequence of the failure to change track in the winter of 1990-91 is that Germany entered the present recession in 1992 with a public sector budget deficit of DM 87 billion (equal to 2.9% of GDP) and a debt mountain of DM 1,200 billion (equal to 40% of GDP).

Further government borrowing, which would now have been justified on cyclical grounds, was out of the question,

as it would have seriously shaken confidence in the German currency. The fiscal authorities had already shot their bolt before battle was joined.

The future path will be difficult. As long as the recession continues, there can be no thought of reducing the public debt. However, as soon as the economy is again working almost to capacity – probably in late 1994, according to the autumn forecast by the economic research institutions – serious measures must be taken to tackle the problem. The need for transfer payments will still be undiminished at that point, so that the Government will not have a choice between cutting expenditure and raising taxes: it will have to do both. It is to be hoped that the additional burdens that will be placed on the economy will not have too serious an effect on the propensity to invest. Perhaps the return to a sound, credible economic policy will restore confidence in the long-term international competitiveness of the German economy to such an extent that the additional burden will appear tolerable.

Michael Frenkel*

Germany's International Competitive Position Under Siege

Germany is sailing through rough waters. The German economic miracle seems to be over.¹ Although the concern about an unsatisfactory economic performance has risen in many industrial countries, it is now frequently argued that the adverse economic developments may be more pronounced in Germany than in other countries.² According to these arguments Germany is losing international competitiveness, which may soon lead to a decline in the standard of living and require a reduction in real wages.

A crucial reason behind the concern about Germany's international competitive position is the weak export performance since 1990. As Figure 1 shows, growth in German real exports has been considerably lower than growth in real world exports. In 1993 the volume of exports will even have gone down compared to 1992. The weak German export performance has raised concerns in

political, business and research circles about the future international competitive position of German products. It is feared that the end of the current recession in Germany and other industrial countries will not lead back to a satisfactory performance in Germany's export industries. In this context it is often argued that there have been structural weaknesses for quite some time but have only recently become more evident.

Undoubtedly, the weak German export performance can be due to a number of factors, for example the trade diversion resulting from German reunification and the recession in Germany's main trading partners. In fact, some argue there is no competitiveness problem in Germany and the poor economic performance is solely due to recessionary effects. This suggests that an evaluation of Germany's competitive position needs to be based on a more detailed analysis of recent developments

* Koblenz School of Corporate Management, Koblenz, Germany. Based on a paper presented at the Conference of the Friedrich Ebert Foundation on "Modell Deutschland under Siege: Social Tensions, Unemployment and International Competition", Washington, DC, Dec. 13, 1993.

¹ This was first stated by R. Dornbusch: The End of the German Miracle, *Journal of Economic Literature*, Vol. 31 (June 1993), pp. 881-885.

² See, for example, Annual Report of the Council of Economic Experts ("Sachverständigenrat") 1993/1994, par. 183.