

Halbach, Axel J.

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Axel J. Halbach*

German Direct Investment: Marked Structural Change

The collapse of socialism and opening up of markets in the East has led to a significant structural change in direct investment behaviour on a worldwide scale. The trend is particularly evident in Germany's direct investment patterns over the past two years. While newly industrializing countries in Latin America and Asia continue to be attractive investment locations, the major losers are the less developed countries, especially in Africa. There is a good deal of evidence to suggest that the countries of Africa, with a small number of exceptions, are increasingly becoming pure recipients of development aid.

The countries which lost World War II have now become the world's largest "creditor" nations. At the end of 1992, Japan's net foreign assets had attained a new record, at a value equivalent to DM 862 billion. Japan's lead over the next country in the net creditors' league, Germany, with DM 560 billion in foreign assets, thus increased substantially during the year. Then there is a long gap before the United Kingdom follows in third place, with net assets equivalent to DM 50 billion. The USA, on the other hand, has now become the world's largest net recipient of foreign capital, with net obligations of over DM 600 billion.¹

The values cited above take in both direct investment and securities portfolios. If direct foreign investment is viewed in isolation, Japan is well ahead with a net figure of approximately DM 420 billion, followed by Germany with approximately DM 280 billion. The main reason why the gap between Japan and all other countries widened so strongly in 1992 was the upward movement in the value of the yen against the dollar and deutschmark during the year, a trend which continued in the first half of 1993 with a renewed appreciation of the yen by almost 20%. Even for these accounting reasons alone, Japan's balance of payments surpluses and its asset position relative to other countries will have grown once more in 1993.

Turning specifically to German direct investment abroad, industrial countries make up by far the most important target region with an 86% share (based on aggregate net transfer values). The share taken up by

developing countries halved in size during the last decade, from 26% at the end of 1980 to just under 13% at the end of 1992. Particularly since 1991, the reforming countries of the former Soviet bloc have played a significantly increased part, though the accumulated total of German direct investment there is still as yet only slightly over 1% of Germany's total direct investment around the world (based on transfer values since 1952). Another factor which has obviously influenced German investment activities abroad is the amount of money western German companies have recently invested in the former territory of East Germany. During 1991 and 1992, estimates amounted to a combined total of just under DM 70 billion; the estimated volume for 1993 was DM 50 billion. Both figures include foreign direct investment of approximately DM 1 to 2 billion per annum in 1992 and 1993.

In global terms, the collapse of socialism in Eastern Europe and elsewhere has created a pronounced structural change in direct investment behaviour that is particularly clearly reflected in the transfers of capital carried out by German firms. If the net transfer values² of German direct investment since 1980 are examined (see Tables 1 and 2), a number of interesting observations can be made:

- Up to 1980 inclusive, approximately three-quarters of

¹ Cf. Süddeutsche Zeitung, 1st June 1993.

² This value is the cumulative total of all annual net transfers since 1952. It naturally does not tally with the actual asset values now carried on the balance sheets of German companies' foreign subsidiaries or branches. Quite substantial discrepancies may arise from region to region, owing to exchange rate movements, reinvested profits and loss write-offs.

* Ifo Institute of Economic Research, Munich, Germany.

REPORT

Table 1

Changes and Intermediate Totals for German Direct Investment 1980-1992

Category	Total as of 31. 12. 80 ^a		Additions in 1981-1988		Total as of 31. 12. 88 ^a		Additions in 1989	
	DM million	%	DM million	%	DM million	%	DM million	%
Total net transfers	74,162	100	97,375	100	171,537	100	21,290	100
Regional breakdown:								
– Industrial countries	54,934	74.1	86,361	88.7	141,295	82.4	20,145	94.6
– Developing countries	19,213	25.9	10,964	11.3	30,177	17.6	1,042	4.9
– Remainder (former Soviet bloc) ^b	15	0.0	50	0.0	65	0.0	103	0.5
Regional breakdown of developing country transfers:								
– Total ^c	19,213	100	10,964	100	30,177	100	1,042	100
– Europe	4,634	24.1	800	7.3	5,434	18.0	160	15.4
– Africa	2,759	14.4	1,849	16.8	4,608	15.3	–40	–3.8
– Latin America	9,127	47.5	4,954	45.2	14,081	46.7	560	53.7
– Asia (incl. Oceania) ^c	2,693	14.0	3,364	30.7	6,004	20.0	362	34.7
Regional breakdown of Soviet-bloc transfers:								
Total European state-trading countries	15	100	50	100	65	100	103	100
– Hungary	.	.	25	50.0	25	38.5	69	67.0
– Former Czechoslovakia	.	.	–	–	–	–	–	–
– Former USSR	.	.	9	18.0	9	13.8	29	28.2
– Former Yugoslavia	.	.	10	20.0	10	15.4	–4	–3.9
– Poland	.	.	–	–	–	–	–	–
– Romania	.	.	–	–	–	–	–	–
– Bulgaria	.	.	–	–	–	–	–	–
– Baltic countries	.	.	–	–	–	–	–	–
– Balancing item not sep. recorded	.	.	6	12.0	21	32.3	9	8.7
Category	Additions in 1990		Additions in 1991		Additions in 1992		Total as of 31. 12. 92 ^a	
	DM million	%	DM million	%	DM million	%	DM million	%
Total net transfers	31,706	100	30,551	100	23,891	100	278,975	100
Regional breakdown:								
– Industrial countries	30,396	95.9	27,244	89.2	21,309	89.2	240,389	86.2
– Developing countries	1,056	3.3	1,978	6.4	1,039	4.3	35,262	12.6
– Remainder (former Soviet bloc) ^b	254	0.8	1,359	4.4	1,543	6.5	3,324	1.2
Regional breakdown of developing country transfers:								
– Total ^c	1,056	100	1,948	100	1,089	100	35,262	100
– Europe	16	1.5	225	11.6	171	16.5	6,006	17.0
– Africa	44	4.2	–12	–0.6	–36	–3.5	4,564	13.0
– Latin America	739	70.0	1,021	52.4	344	33.1	16,745	47.5
– Asia (incl. Oceania) ^c	257	24.3	714	36.6	560	53.9	7,947	22.5
Regional breakdown of Soviet-bloc transfers:								
Total European state-trading countries	254	100	1,359	100	1,543	100	3,324	100
– Hungary	201	79.1	462	34.0	826	53.5	1,583	47.6
– Former Czechoslovakia	2	0.8	799	58.8	536	34.7	1,337	40.2
– Former USSR	33	13.0	15	1.1	14	0.9	100	3.0
– Former Yugoslavia	28	11.0	123	9.1	65	4.2	222	6.7
– Poland	7	2.8	62	4.5	146	9.5	215	6.5
– Romania	–	–	2	0.1	11	0.7	13	0.4
– Bulgaria	11	4.3	–	–	3	0.2	14	0.4
– Baltic countries	–	–	–	–	4	0.2	4	0.1
– Balancing item not sep. recorded	–17	–6.7	–104	–7.7	–62	–4.0	–153	–4.6

^a This aggregate is calculated simply by adding together the net transfer values since 1952; it differs substantially from the current value of assets as recorded on balance sheets; the latter differs from the pure cumulative total of net transfers due to exchange rate changes, reinvestment of profits or loss write-offs. ^b Only the European former state-trading countries are included in this category. ^c Includes Asian former state-trading countries.

Sources: Bundesanzeiger, various editions; Vermögensanlagen Gebietsansässiger in fremden Wirtschaftsgebieten; ifo Institute's own calculations.

the foreign investment originating in West Germany was placed in industrial countries, and the remaining quarter in the "Third World". The Soviet-bloc countries did not feature in this picture. Within the developing country group, just under half of the total capital transferred went to Latin America, approximately a quarter to what were then developing countries in Europe, and about 14% each to Africa and Asia.

□ The aggregated transfer values for the period 1981-1988 again, for obvious reasons, show little attention being paid to the former Soviet-bloc. The other main feature, however, is a far stronger concentration than before on investing in other industrial countries, which took up a share of almost 90% in this period, leaving only a share of approximately 10% for direct investment in developing countries. Within the latter category (i.e., taking this as 100%), the foremost region was Latin America, with a 45% share; only 7% was now taken up by European countries (mainly because of the reclassification of former developing countries there), while Asia grew substantially in significance with a 30% share, and Africa retained roughly the same share as in the past, at about 17%. These changes are reflected both in absolute and in percentage terms in the accumulated values entered for 31st December 1988 (see Table 1).

□ Another, deep-seated structural change began in 1989. The additions recorded each year from 1989 to 1992 clearly reflect the following trends: the other industrial countries are continuing to gain ground as a target region, taking in a share of German direct investment of 90% and above since the world political turn-around. The developing countries' share has declined to as little as 4-5%, while the European former Soviet-bloc countries have been attracting increasing interest: the 6.5% share they attained in 1992 meant they had drawn half as much investment capital again from Germany as the entire developing world which was left with 4.3% (see Table 1).

□ Among the developing countries themselves, another marked shift has occurred in the prime points of emphasis. This is reflected in the average annual net transfer per period documented in Table 2. From 1981 to 1985, Latin America headed the table with a 56% share, and Africa and Asia followed with 18% apiece. In the succeeding 1986-1988 period, the Latin American debt crisis caused this region's relative share to fall to just 5% – one tenth of its previous share – while Europe and Africa took up 10%

each in the developing country category, and almost three-quarters of the net transfers now went to Asia. Finally, during the 1989-1992 period Latin America regained its former credit standing and attractiveness to investors, and its share returned to around the 50% mark as before. By contrast, the economic crisis in Africa is disastrously evident in the amount of direct investment placed there: there was no longer any net inward investment into the continent from Germany at all, but in fact a small net capital outflow. Asia occupied second place with a 37% relative share.

□ The only African country to show a clear gain in 1991 and 1992 was South Africa, which is classified as an industrial country (the net capital inflows were DM 129 million and DM 107 million respectively); apart from Nigeria (DM 24 million in 1991), hardly any interest was attracted by the continent's other countries. As for Latin America, three-quarters of the investment made in the same two years went to Mexico, Argentina, Brazil and, some way behind the others, Venezuela. In Asia, German direct investment was concentrated almost exclusively (96%) in China, South Korea, Malaysia and Singapore.

□ Finally, quite new developments have been occurring in the European former Soviet-bloc countries. Having previously played an entirely insignificant role as recipients of direct investment, these countries now form a rapidly growing target region. After shares of 0.5% and 0.8% respectively in 1989 and 1990, this jumped to 4.4% in 1991 and 6.5% in 1992, which meant that more money was invested in what are now known as the reforming countries than in all developing countries put together from three continents (4.3%). This trend was even more pronounced in the first half of 1993 when, for example, German direct investments in the Czech Republic alone (DM 339 million) surpassed all investments directed to Asia and Africa taken together (DM 321 million). Thus the opening of the eastern countries was clearly detrimental to those of the developing world. A regional breakdown among the former Soviet-bloc countries shows Hungary and Czechia/Slovakia at the top of the list, followed some way behind by Poland. Another significant point about this upsurge is that it took place against the background of a worldwide recession, which induced a reduction in Germany's total foreign investment of DM 7 billion in 1992 relative to the previous year.³ It is fair to assume that the former eastern bloc would have attracted still more investment capital if the world economy had not been in such a weak condition.

□ Eastern Europe is not only an attractive location from Germany's point of view. Compared with a figure of just \$446 million in 1989, the direct investment inflows from the rest of the world into former Czechoslovakia, Poland,

³ The main factor responsible for this decline was the lower level of German direct investment in the other EC countries; it was down just under 27% against the prior year. Belgium was now the largest recipient, accounting for DM 6.3 billion, while the USA, which had often headed the list in the past, was down to only DM 2.7 billion.

Slovenia and Hungary in 1992 were ten times that amount at \$4.5 billion, with Hungary in particular way out in front, attracting \$3.4 billion of that sum. The total inflows from the rest of the world into the above four/five countries since 1989 come to \$8.8 billion, and the trend continues upwards.⁴ The main investment motives are the desire to tap new markets close by and the low cost of labour which, for the time being at least, is even lower than in some developing countries.

Though the positive response of German companies to the new low-wage countries and promising new markets right on their doorstep is quite understandable, it nevertheless gives cause for concern. Does this mean that the "Third World" is being left by the wayside? As far as Asia and Latin America are concerned, this is evidently not the case, and the relationships and markets built up in the past will continue to generate a steady stream of German direct investment. But what will then be left over for sub-Saharan Africa? Not only is this increasingly being identified as the actual problem continent, but it also has not so far shown any signs of gradual, sustainable improvement. It is understandable that private capital reacts particularly sensitively in this case. Official development aid faces a similar dilemma: both the central Asian former Soviet countries and the formerly socialist countries in southern and eastern Asia now claim their own slices of a cake which has not grown any larger in total. At present, there are only a few encouraging examples of serious economic reform (e.g. in Zimbabwe, Kenya,

Ghana, Nigeria and Cameroun), but this is more than outweighed by the relapse into self-destruction (e.g. Angola, Zaire, Somalia, Sudan and Mozambique) or at least economic "disorder" seen elsewhere.

Africa is still well behind as a capital recipient when viewed from an international rather than a German standpoint. Loans approved by the World Bank and its subsidiary the International Development Association (IDA) are no exception to this situation. In its 1992/93 financial year (ending on 30th June), the World Bank group granted the largest ever volume of new lending, valued at \$23.7 billion (against \$21.7 billion the previous year). A glance at the regional distribution of these funds again shows a tremendous increase for the former Soviet-bloc countries, which received \$3.9 billion (against \$2.1 billion the previous year). Africa, by way of contrast, has to content itself with \$2.8 billion in new lending, a reduction of \$1.2 billion, or 30%, on the previous year. Among the reasons cited by the World Bank for these changes are political adversities in Africa. The decline also serves as an illustration of the bank's wish to pay greater attention to the quality of its loan portfolio. An internal study completed in the autumn of 1992 which has become known as the "Wapenhans report" concluded that an above-average proportion of loans had to be written off as failures. Lending to Africa played a by no means insignificant part in generating these criticisms.⁵

The Organization for Economic Cooperation and Development also publishes data on the net transfer of

Table 2

Structural Change in German Direct Investment: 1981-1985, 1986-1988, 1989-1992

Category	Avge. annual net additions 1981-1985		Avge. annual net additions 1986-1988		Avge. annual net additions 1989-1992	
	DM million	%	DM million	%	DM million	%
Total net transfers	10,067	100	15,681	100	26,860	100
– Industrial countries	8,350	82.9	14,871	94.8	24,774	92.2
– Developing countries	1,714	17.1	798	5.1	1,271	4.7
– European former Soviet bloc	3	0.0	12	0.1	815	3.1
Developing countries total	1,714	100	798	100	1,271	100
– Europe	111	6.5	81	10.2	143	11.3
– Africa	316	18.4	89	11.1	–11	–0.9
– Latin America	967	56.4	40	5.0	666	52.4
– Asia	320	18.7	588	73.7	473	37.2
European state-trading countries total	3	100	12	100	815	100
– Former Czechoslovakia	0	–	0	–	334	41.0
– Hungary	1	33.3	6	50.0	390	47.9
– Poland	0	–	0	–	54	6.6
– Former Yugoslavia	0	–	3	25.0	53	6.5
– Former USSR	0	–	3	25.0	23	2.8
– Disinvestment not sep. recorded	–	–	–	–	–43	–5.3

Sources: See Table 1.

resources from industrial to developing countries (see Table 3). In total, the OECD recorded a much larger capital flow in 1992 than in 1991, but this was not so much attributable to direct investment as to a marked increase in private-sector bank lending. At \$40 billion, the latter reached its highest level for ten years. However, as the OECD emphasizes, this does not mean to say that the developing countries' debt crisis has been resolved. In 1992, total Third World debt went on rising, and reached a year-end figure of \$1,534 billion. Moreover, the new private-sector bank lending (most of which is provided on short terms) has generally benefited just a small number of

developing countries, notably Mexico, Brazil, Argentina, India, China and Indonesia, with Kuwait and Saudi Arabia also now featuring among the borrowers. The poorest developing countries, and hence many African countries, were again largely excluded from this private-sector finance in 1992.

Official development aid by OECD countries came to \$72.3 billion in 1992, which was only about the same as the previous year in real terms. Measured in terms of the donor nations' gross national product, too, official aid stayed at the previous two years' average of 0.33%. In absolute terms, the USA remained the world's largest donor nation, spending \$11.66 billion; it was followed by Japan with \$11.15 billion, France which spent \$8.29 billion, and Germany \$7.57 billion.⁶

The OECD's regional breakdown for 1992 was not available at time of writing. However, the 1991 figures (see Table 4) provide a fair indication of how official development aid (ODA) is likely to have been distributed a year later. As mentioned above, Africa, unlike Latin America and Asia, hardly increased its intake of other forms of net transfer, particularly direct investment and bank lending.

When official development aid is examined as a category in itself, the leading recipient regions are sub-Saharan Africa and Asia, receiving approximately one third each. The remainder is divided among North Africa and the Middle East, Latin America, Europe and Oceania. By way of contrast, sub-Saharan Africa's share of other financial transfers (which totalled \$73 billion in 1991) was only just over 5% (against 9% in 1985), while Asia received more than half, and Latin America one third.

These data suggest that Africa's future development prospects are hardly encouraging. Official development aid to Africa is no longer increasing, while on the direct investment front (with the exception of South Africa) the current tendency is rather for there to be a net outflow of capital, and African countries have hardly played a part as recipients of private-sector bank lending. Furthermore, as economic developments in some Eastern European countries increasingly begin to stabilize, the traditional developing countries, and especially those in Africa, are faced with a serious new rival which will increasingly tend to draw in both direct investment and other financial transfers. Not a happy prospect for this crisis-torn continent.

⁴ Cf. Süddeutsche Zeitung, 30th July 1993.

⁵ Cf. also Neue Zürcher Zeitung, 8th July 1993.

⁶ Neue Zürcher Zeitung, 7th July 1993 (from data supplied by the OECD).

Table 3

Net Transfer of Resources from OECD to Developing Countries

(in \$ billion, at current prices)

Category	1990	1991	1992
Official funds	69.4	70.2	72.3
– Bilateral	45.9	46.2	47.3
– Multilateral	23.5	23.8	25.0
Export credits	4.5	1.8	3.5
Private-sector funds	56.6	62.2	99.8
– Direct investment	26.9	26.4	30.6
– Bank lending	15.0	11.0	40.0
– Other transfers	14.7	24.8	29.2
Total	130.5	134.0	175.6

Source: Neue Zürcher Zeitung, 7th July 1993 (from data supplied by OECD).

Table 4

Net Transfer of Resources to Developing Countries by Region

(at constant 1990 prices and exchange rates)

Region	1990		1991	
	\$ billion	%	\$ billion	%
Sub-Saharan Africa	23	18.1	23	18.1
– of which ODA	19	35.8	19	35.2
North Africa and Middle East	9	7.1	9	7.1
– of which ODA	8	15.1	8	14.8
Asia	59	46.5	56	44.1
– of which ODA	17	32.1	18	33.3
Latin America	20	15.7	31	24.4
– of which ODA	7	13.2	7	13.0
Other (incl. Europe and Oceania)	16	12.6	8	6.3
– of which ODA	2	3.8	2	3.7
Developing Countries				
Total	127	100	127	100
– of which ODA	53	100	54	100

Source: OECD: Development Co-operation, 1992 Report, Paris 1992, p. A-24.