

Foders, Federico

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## Trade promotion in the Federal Republic of Germany

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# TRADE PROMOTION IN THE FEDERAL REPUBLIC OF GERMANY<sup>1</sup>

*Dr. Federico Foders*

*Kiel Institute of World Economics  
Federal Republic of Germany*

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## I. INTRODUCTION

In the past three decades, the West German economy has been characterized by a strong world market orientation. According to key indicators of trade performance West Germany belongs to the exclusive club of foreign trade champions. It currently exports about a third of its gross domestic product (GDP). It achieved a positive current account balance averaging around four per cent of GDP in the second half of the eighties and it holds a market share between 13 and 16 percent of world non-oil merchandise exports and even higher shares for selected industrial products. The purpose of this paper is to give an account of the institutional framework for Germany's success in world trade, focusing on the way in which the foreign trade sector is organized.

The product and regional structure of German foreign trade reveals the strengths and weaknesses of Germany as location of economic activity exports are concentrated in manufactured products with capital goods accounting for more than half of total exports. Important products are electrical and non-electrical machinery, road vehicles and textiles. Regionally, German exports are oriented towards industrial market economies, especially towards

the member countries of the European Communities (EC). Less Developed Countries (LDCs) and member countries of the Council for Mutual Economic Assistance (CMEA) together account for about a quarter of German exports. Industrial market economies are also the most important source of German imports with the EC countries again playing a leading role. A quarter of German imports have their origin in LDCs and CMEA countries.

German exports are dominated by products with medium and high technology intensity notably electrical and non-electrical machinery, road vehicles and chemicals (including pharmaceuticals): This fact reveals the importance of the research and development effort in influencing the structure of foreign trade. The international competitiveness of German industry has thus been achieved through specialization in the mentioned areas. Other areas as for instance microelectronics were left to other important players in the world markets, particularly to the US and Japan. International competitiveness as revealed by world market shares is however permanently changing. The challenge ahead for German industry is to participate in this never ending technological race by finding appropriate responses to the dynamic forces driving the world economy.

## II. THE DEMAND FOR TRADE PROMOTION

The typical foreign trader (exporter or importer) has four major needs:

- (i) information on world markets
- (ii) contacts in foreign countries
- (iii) sources of finance and
- (iv) insurance against the risks involved.

It is virtually impossible to penetrate a foreign market without information on:

- political developments
- economic policies
- the structure of a particular market
- foreign suppliers of the same product or service
- foreign suppliers of similar products or services
- prices prevailing in foreign markets

- exchange rates
- trade fairs in foreign countries
- international tenders and large scale projects
- legal aspects of trade and investment
- technical aspects of trade: documentation tariffs, non-tariff barriers and
- transport routes; low cost carriers.

Generally speaking information is becoming increasingly important as a production factor, virtually no firm or sector can do without it as one can infer from the rapid diffusion of computers and computer software. The ability to handle large amounts of information together with the revolution taking place in communication equipment is expanding the possibilities for trade and investment. Importers want to contact foreign suppliers and exporters want to contact foreign importers. Investors want to know where the best locations for economic activity are and which local companies could qualify for joint ventures. Also companies seeking foreign credit or foreign technology might be interested in establishing links with foreign companies.

Furthermore, firms willing to engage in selling and shipping merchandise across national boundaries have to be aware of the different ways of (1) financing international transactions, (2) insuring against the risk of non-completion of these transactions and (3) protecting against exchange risk.

Most international trade involves a time lag, which means that funds are tied up during the period the merchandise is in transit. Banks can deal with the financial aspects of trade. They can help to bridge the time gap between despatch of goods and receipt of payment, a gap which is usually much longer for export sales than for domestic sales.

Financial packages may be dependent on the risk of non-completion of the transaction. This risk is faced by both the buyer and the supplier. The seller wants to maintain legal title to the goods until paid or least until assured of payment; the buyer is reluctant to pay before receiving the goods or at least before receiving title to those goods. Uncertainty arises because buyer and seller have limited knowledge about each other, due to longer transportation and communication lines, and other "natural" barriers (language, culture etc). Much of the risk of non-completion is reduced through the use of three documents in consumer and intermediate goods trade. The letter of credit (bank guarantee of payment against documents, requested by the buyer) the draft (bill of

exchange written by the seller requesting payment), and the bill of lading (shipping documents.)

In the case of capital goods special forms of export finance and the insurance against the risk of non-completion are necessary. Common instruments are supplier and buyer credits. These credits may involve recourse to the exporter, the importer or alternatively, to a guarantor, usually a government funded institution as a means of providing insurance against the risk of non-payment.

Finally, in financing trade and handling the risks involved also invoicing in a foreign currency has to be taken into account. The transaction might be invoiced in the exporter's or the importer's currency, or in a third currency. Wherever different currencies and an interval of time between agreement on price and final payment exists, one or other of the parties involved, if not both, are likely to be exposed to the risk that exchange rates might change. The consequence of this is that the value of outstanding obligations incurred prior to the change in exchange rates but to be settled after that change might also change in an unexpected way, leading under certain circumstances to economic losses. Protection against this risk can be acquired in the international money market and/or in the foreign exchange market. Generally exposure to foreign exchange risk is likely under very different exchange rate regimes, depending always on the length of the period between agreement on price and actual payment.

### III. THE SUPPLY OF TRADE PROMOTION IN GERMANY

Germany's foreign trade sector is mainly privately organized. By international standards West German industry receives only very little public support in the form of specific trade promotion. The total effort is the lowest of all industrialized countries. Germany currently (1989) spends only about 0.02 per cent of export value or approximately US\$0.50 per head in trade promotion. In spite of that, governmental support plays a qualitatively important role in this context. Since the backbone of the German economy is not, as one might expect, made of a few big transnational companies but rather of many small and medium-sized enterprises, the government has the duty to ensure that even the smallest exporter or importer has the access to information contacts, finance and insurance.

In order to achieve this, the government maintains a series of services for foreign traders which are offered through government, private and mixed organizations. In fact, the second major feature of the German trade promotion system is that financial support by the government is only rarely distributed directly by governmental agencies; most of these aids are channeled through private industry organizations. It should be noted, however, that German industry enjoys indirect official trade promotion in the form of considerable subsidization, particularly in the field of research and development, which has a direct impact on international competitiveness of German products. This type of government support will not be discussed any further in this paper.

### *A. The Federal Agency for Foreign Trade Information*

The largest state export promotion institution is the "Bundesstelle für Außenhandelsinformationen (BfAI)" (Federal Agency for Foreign Trade Information) which collects information on foreign markets and offers consulting services. Information and consulting are made available to German firms at very low cost. Founded in 1951, this agency is funded by and functions under the authority of the Federal Ministry of Economics. A small part of its budget is financed by the sale of publications to the public. The agency has staff working in its head office in Cologne and staff working as correspondents in more than 50 countries.

Information collected includes economic policies in foreign countries, markets, products, suppliers, buyers, projects in progress, tenders, trade-fairs, trade and investment regimes, tariffs and non-tariff barriers. German companies also have access to the agency's library with about 2,000 newspapers and journals from many countries and to an online databank with current trade information. In addition, since the agency does not only serve German traders but also foreign traders, it also publishes reports in English on the German economy and the German trade regime.

### *B. The Umbrella Organization of Regional Chambers of Commerce and Chambers of Commerce Abroad*

This private organization, "Deutscher Industrie und Handelstäg (DIHT)", which is subsidized by the government, offers information, consulting services, contacts with foreign firms and certificates of origin as well as other legal

services. The information coverage is similar to the one offered by the agency presented under A.

The German foreign network of chambers of commerce comprises of 44 chambers, which have been established on a bilateral basis in order to foster mutual trade and investment interests. Membership is compulsory for German companies as far as regional chambers of commerce in Germany are concerned. Membership in international chambers is voluntary.

The most important service of this organization is to provide for contacts between German and foreign firms. German companies are informed in detail about foreign suppliers/buyers, including their financial standing and business record. Also, the chambers help in case of legal conflict between German importers/exporters and foreign firms. The German foreign service provides contacts with non-German chambers through its embassies and consulates. Who pays for the services provided by the chambers of commerce? Member companies may make use of these services free of charge, whereas non-members are charged only low rates, compared with, say, the rates charged by private consultants.

### *C. The German Small Business Association*

Services geared at small and medium sized companies are made available through the "Rationalisierungskuratorium der deutschen Wirtschaft" (Small Business Association). Smallness of a firm is given by its sales level. Different sales limits have been set for the different economic sectors (industry, commerce, financial services, other services) in order to identify small firms.

This association distributes government subsidies for consulting, especially for marketing studies referring to foreign countries. Such subsidies cover a compensation for the consultant(s) as well as other expenses (travel costs).

### *D. The German States (Länder)*

The eleven German Länder also engage in export promotion by offering essentially the same services which are available at the federal level. The difference between the federal and the Länder promotional system is that the Länder take into account regional priorities. They therefore may support firms which gained a certain regional importance arising from the role as employers or taxpayers. Often, these firms play a key role for regional economic

development but do not fit into the federal programmes, as for instance, the subsidy programme for small firms. In those cases, the Länder are the only source of promotion for such firms.

On the other hand, the Länder have the responsibility for certain promotional activities which are managed jointly with the Small Business Association's regional branches. Most of the support to most firms is channeled through these local organizations (see C.).

### *E. Federal and Länder Aid for Small Firms*

The federal and the Länder governments finally offer incentives to small firms willing to participate in trade-fairs taking place in foreign countries. They provide

- Information on foreign trade fairs (what, where, when),
- Organization for German firms willing to participate (joint stands, joint publicity, etc.), and
- Subsidies for groups of firms participating in foreign fairs and supplying similar or somehow related products or services.

### *F. The Financing of German Foreign Trade*

Since the bulk of German trade takes place with developed market economies, this part of foreign trade is financed through the market, i.e., through private banks. The role of the government is to provide for finance and guarantees for the smaller part of German foreign trade, which is carried out with developing countries and centrally-planned economies. German companies face much higher risks in trade with LDCs and CMEA countries than in trade with other industrialized countries. Government support is meant to offer some compensation for this higher risk, particularly in the case of small and medium-sized firms. However, one type of risk, namely currency risk, is generally excluded from government compensation.

Support is channeled mainly through three institutions:

- The government-owned German Bank for Reconstruction,
- The privately-owned German Export Credit Agency, and
- The privately-owned German Export Guarantee Agency.



### *1. The German Bank for Reconstruction*

The "Kreditanstalt für Wiederaufbau (KfW)" was founded after World War II under the auspices of the European Recovery Programme to finance the postwar reconstruction of the West German economy. Since the early 1960's, the activities of the KfW shifted to other fields, among others, to the financing of capital goods exports. The KfW makes long-term credits available to the foreign importer of German capital goods. In other words, the KfW allocates so-called "buyer credits". The loan can be made directly to the overseas buyer or, as in most cases, via an intermediary organization (usually a bank) in the importer's country. There is no recourse to the exporter if the buyer defaults.

The KfW provides two credit lines at commercial interest rates. One credit line foresees borrowing for a period of at least seven years; firms of all sizes are eligible. The other line is geared at small firms and at periods not less than four years. Both lines are conditional on export credit guarantees from the German government. The credit volume depends on the value of the exported capital goods: (i) capital goods up to DM 25 million entirely financed (100% of value), (ii) capital goods between DM 25 and 50 million are eligible for a credit of up to DM 25 million, and (iii) capital goods over DM 50 million are eligible for a credit volume equal to 50% of value up to a maximum amount of DM 85 Million.

### *2. The German Export Credit Agency*

The "Ausfuhrkreditanstalt (AKA)" has been established by German commercial banks to specialize in trade finance. Although it is called "export" credit agency, it also offers borrowing facilities for importers. In contrast to the KfW, which makes loans available to the (foreign) buyer of German capital goods, the AKA awards credits to the German supplier of consumer and intermediate goods. Credit volume does not amount to 100% of export value. Rather, the exporter is expected to provide between 10 and 15 per cent of export value in accordance with regulations on government export credit guarantee schemes: 15% if the (foreign) buyer of German goods is a private firm and 10% if the (foreign) buyer is a government or a government institution.

Also, in contrast to the KfW's credit policy, credits approved by the AKA are for short and medium-term periods. Their cost almost matches commercial interest rates, since they involve a variable mark-up over the rediscount rate of the German central bank (Bundesbank).

### 3. *The German Export Guarantee Agency*

HERMES is a private insurance company which provides export credit guarantees on behalf of the German federal government. Also, it may arrange insurance against currency risk but only at commercial terms through the banking system. Guarantees are offered to German firms selling to foreign private firms or foreign governments or government institutions. These guarantees are tailored to cover the following risks:

- pre-shipment risk: risk of interferences with the production of the goods exported (mainly for capital goods),
- post-shipment risks: economic risk of default and political risk of default or of damage of goods shipped.

Guarantees are conceived either as covering a single sale or as covering a series of sales of a German supplier to one or more buyers in one or more foreign countries. Guarantees are conditional on certain domestic content rules, shipment periods and credit lines. In case of default the exporter is required to bear a small percentage of the loss, namely 10% in case of default for political reasons, and 15% in case of default for economic reasons, including protracted default. A special guarantee scheme pertains to tied loans made to foreign firms and governments or government institutions.

### G. *Final Remarks*

The excellent trade performance of the German economy in the postwar period is, of course, also closely related to the German trade regime. This world-market oriented regime has been particularly influenced by the general macroeconomic framework, which, in turn, reflected non-inflationary monetary and fiscal policies, in addition to an exchange rate policy aiming at a compensation for the high real wage level observed in Germany since the 1960's.

However, exporters have had to bear the cost of protection. In fact, exporters were taxed by the heavy protection offered to the so-called declining industries, as iron and steel, and shipbuilding, i.e., labour-intensive industries which could not survive in a location featuring excessively high real wages. Protection had the effect of retarding structural change in those industries, thereby further deepening Germany's comparative disadvantage in those products. To the extent that these products were used as inputs into products of the dynamic industries, the latter had to bear higher costs than their competitors in the world.

markets. Although compensation through an accommodating exchange rate policy was sought, monetary stability did not allow for a complete compensation.

All in all the gains from trade have been impressive, although in recent years export surpluses have been associated with substantial capital outflows, indicating that Germany has been losing attractiveness as a location of economic activity, due to high real wages and high income taxes.

### *FOOTNOTE*

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1. Revised version; the original title was: Organization, Structure and Financing of German Trade