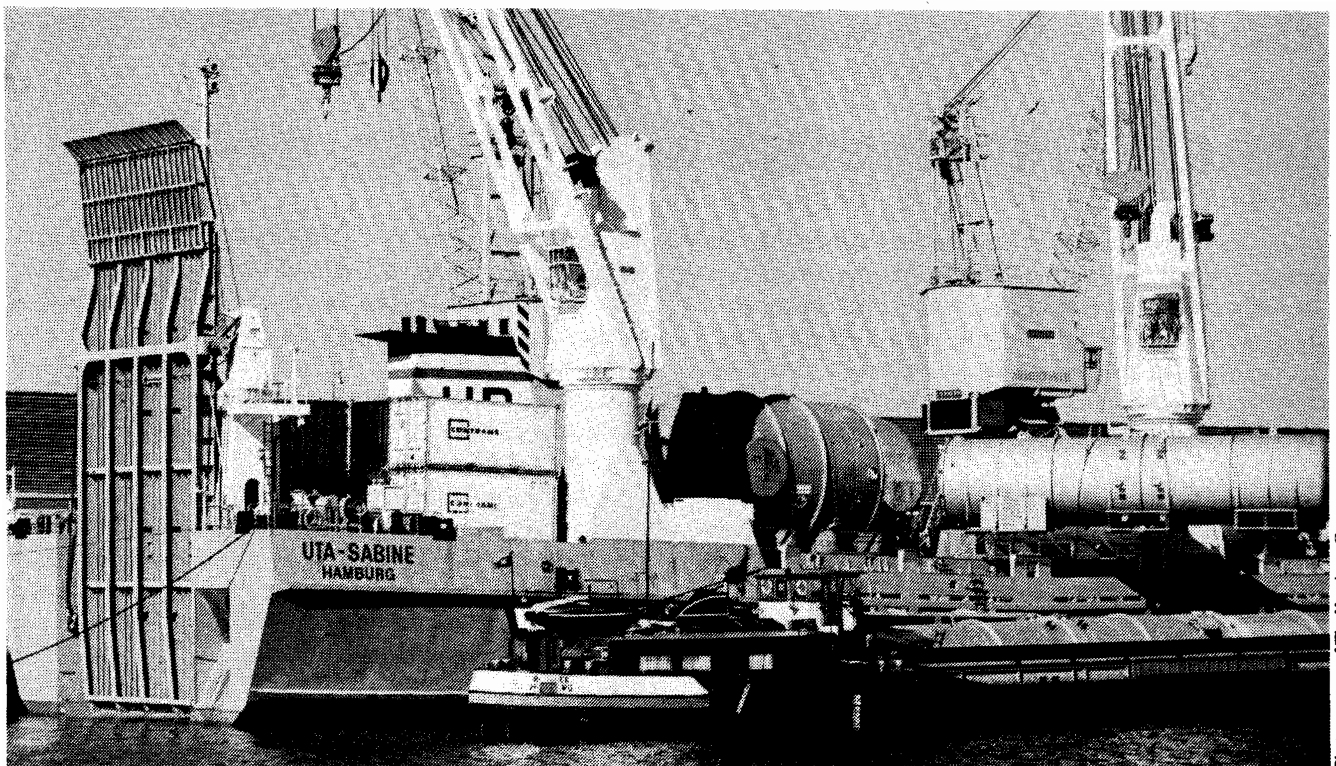

Photo courtesy of The Hamburg Group

Is the German economy losing its competitive edge?

by Alice Roth

The foreign exchange markets have become "a theater of the absurd," declared Manfred Lahnstein, West German state secretary for finance, as the deutschemark slid to new two-year lows last week against the U. S. dollar and four-year lows against the British pound sterling. It *is* absurd that the West German currency, representing an economy with five percent inflation rates and—until recently—fairly good growth rates, could be considered in worse shape than those of Britain and the United States, where output is plunging and inflation persists at rates of 13 percent and 16 percent respectively. Double-digit interest rates in the U.S. and Britain have made the dollar and pound sterling temporarily more attractive.

There is a grain of truth, however, in the currency markets' gloomy verdict on the West German economy. While the West German economy may still be showing a superior performance relative to other leading industrialized countries, it may fall short of what is required to survive the 1980s.

The success of any economy during this difficult period will depend on whether it can expand capital investment, apply new technologies, and boost productivity sufficiently to offset the higher costs of oil, while raising living standards to the levels required to properly assimilate technological advances. Historically, exports have been the chief way West German industrialists have funded high rates of capital formation.

Since the early 1970s, however, the rate of growth of West German export markets has slackened because of slower economic growth among primary trading partners—the members of the European Community—and the lack of an international financial mechanism to underwrite expanded capital goods imports by the non-oil-producing developing countries. Within this framework of relatively slower global growth, Japanese industry—characterized by a high degree of cooperation between business and government, long-term planning, and a readiness to apply off-the-shelf technologies—has gained a competitive advantage in many strategic economic sectors.

Yet in the 1980s, such competition need not be an urgent fact of life. If world markets were expanding—as

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European Monetary System Phase Two credits would have achieved—rivalry with Japan and with fellow EC manufacturers would have become a marginal consideration.

Japan's success in such areas as fuel-efficient automobiles and consumer electronics is well known—Japanese imports grabbed 10.1 percent of West German domestic auto sales during the first nine months of this year compared with only 5.6 percent in 1979. This would not be a matter of concern if it were not for the fact that "Japan, Inc." is now positioning itself for a rapid expansion in technology-intensive capital goods exports, the bread and butter of West German industry.

The September issue of the *IFO Digest*, a publication of the Munich-based Institut für Wirtschaftsforschung (Economic Research Institute), declares that, among the leading industrial nations, Japan has "by far the best starting position for the 1980s." IFO cites a study comparing export shares of products with high-technology content. With the average share of all countries set at 100, the index for Japan rose from 73 in 1960 to 179 in 1979. Over the same period, the West German index actually fell from 209 to 171. The U.S. stayed constant at 145 and Britain fell from 182 to 114. (The ability of the U.S. to maintain a constant share reflected continued predominance in certain specialized areas, such as aircraft and electronics.)

Vulnerabilities not so new

West Germany's weakened international competitiveness shows up to an extent in the country's recent foreign trade and payments statistics. In August, West Germany recorded its first monthly trade deficit in 15 years. While the deficit amounted to only DM 133 million and could be attributed almost entirely to higher oil prices, the September Bundesbank report highlighted a disturbing feature of recent trade patterns: despite a drop-off in domestic economic activity during the May to July period, imports of finished goods continued to grow at a good clip. The growth in finished goods imports from the U.S. and Japan was particularly remarkable, up 35 percent and 31 percent respectively compared with May to July 1979. (In the case of the U.S., a cheaper dollar was a contributing factor).

West Germany's dependency on finished goods imports is not a wholly new phenomenon, either. According to the Bundesbank, the share of finished goods imports in total imports has gradually increased from only 25 percent in the mid-1960s to 40 percent at present. Moreover, capital goods imports have been a major component of the growth in finished goods imports in the recent period, rising *twice as fast* as the entire expenditure of the domestic economy for new capital goods.

In part, this increased demand for foreign capital goods reflects a hidden strength in the West German economy—industrialists' determination to modernize and expand their plant and equipment, in the face of an international recession and despite the fact that the resources required for this modernization effort cannot be generated entirely from within the domestic economy. The IFO estimates that West German gross national product will grow by only 2.0 percent this year in real terms (with most of the growth concentrated in the first half) and will show zero growth in 1981.

However, the institute sees capital formation continuing at a high level, with purchases of machinery and equipment expanding at a 6.5 percent rate and construction activity (including housing) growing by 5.5 percent in 1980.

Although these two categories of capital investment are expected to fall off somewhat in 1981, declining by 2.0 percent and 2.5 percent respectively for the year as a whole, the institute expects a strong revival in capital spending to begin by mid-1981.

Capital investment flows

Much of this increased investment is being directed into strategically important high-technology capital goods industries, including aerospace, electric and electronic equipment, precision instruments and optics, as well as West Germany's traditional strong point—nonelectrical machinery. As in the United States, large sums of money are also being channeled into retooling the auto industry to produce smaller, fuel-efficient cars.

The West German auto industry expects capital expenditures to jump this year to DM 9.5 billion compared with DM 7.4 billion in 1979 and DM 5.7 billion in 1978. A great deal of attention is being given to automation and the introduction of robots to curry the "energy-saving" small car trend. However, this presently wasteful form of investment (much more energy could be saved by building nuclear power plants) will have some useful side effects in the form of increased productivity.

Meanwhile, both the strengths and the limitations of West Germany's industrial strategy have come into focus in the context of the current EC steel dispute. Unlike the United States, West Germany has not treated its steel sector as a "sunset" industry. West German industrialists have understood the unviability of an "information economy" resting upon a shrinking heavy-industry base and that steel must continue to be produced cheaply and efficiently, and in growing quantities to meet the requirements of steel-consuming capital goods and consumer durables sectors.

The steel battle

During recent years, West German steel makers have devoted considerable sums to the replacement of

obsolescent capacity, with the result that the average age of plant and equipment in the industry is now only 10 to 15 years. While EC industry commissioner Etienne Davignon, British industry minister Keith Joseph, and President Carter's deputy special trade representative Robert Hormats are calling for a planned shrinkage in OECD countries' "excess" steel-making capacity, West German producers have a very different perspective. In private discussions with *EIR*, they forecast a world steel *shortage* emerging in the 1980s, particularly if the developing sector is to make further strides toward industrialization.

The accompanying article by *EIR* European correspondent George Gregory, elaborates on the West German position in the EC steel dispute. The West German companies objected to Davignon's efforts to impose mandatory across-the-board production cuts in the EC industry, on the ground that they had recently invested heavily in high-value specialty steels which could not be accorded the same treatment as other types of steel. In the end, West Germany did gain some exemptions for specialty steel, but agreed to overall cutbacks amounting to some 18 percent, out of fear that waning consumption of steel in the current recession could spark cutthroat competition among EC producers.

The fact that the West German producers were forced to accept this compromise and that Hoesch is now postponing the construction of a DM 500 million plant in Dortmund reflects a larger failure in West German political diplomacy—the failure to move ahead on the creation of new monetary institutions (e.g., the EMF) that could provide the developing sectors with the wherewithal to pay for increased capital goods imports.

An associated problem is the reluctance of the Bundesbank to lower domestic interest rates, out of concern that this would spur greater speculation against the deutschemark and cause further outflow of capital to Wall Street and London. Deutsche Bank chairman Wilhelm Christians recently complained that, if rates did not drop off soon, capital investment would decline along with labor productivity—the motor of the West German "economic miracle."

A report issued by spokesmen for the five leading economic institutes last week, the so-called Five Wise Men, even went so far as to argue that the Bundesbank should tolerate a short-term deutschemark devaluation, if necessary, to reduce interest rates and get the economy moving again. But, as the West German financial daily *Handelsblatt* pointed out, devaluation is not a realistic solution because of the problems it would create for West Germany's European trading partners, and could even undermine the fixed-rate arrangements of the European Monetary System (EMS).

German steel battles the EC

by George Gregory

After seven and a half hours of bargaining into the night of Oct. 30, of German government team, sent to the European Commission of the European Community (EC) to salvage German steel producers in the "manifest crisis" of the European industry, agreed to accept secret production quotas supervised by the EC Commission for the eight months up to June 30, 1981. As far as German producers were concerned, even before the decision, the best of all possible deals, the most magnanimous concessions, were going to amount to a very miserable package. One that, at best, offered no solution to shrinking markets and price war conditions.

The Oct. 30 decision had an eerie aura of historical irony. On Sept. 30, 1926, steel industrialists from Belgium, Luxembourg, France, Germany, and the Saar, met in Brussels under chairmanship of Emile Mayrisch, president of the Dutch-Luxembourgeois Arbed firm, to work out a cartel arrangement to regulate competition and restrict "overproduction," under crisis conditions created by the Versailles Treaty, British control of international credit flows, and general contraction of world trade.

This time, the job of current Arbed president Emmanuel Tesch, as chairman of the voluntary Eurofer club for European steel makers, has been replaced by Belgian Count Etienne Davignon in an obligatory club. Even if the deal wrung out of Count Davignon did not "punish" German producers as they had feared, they still felt cheated. Fifteen years ago, German producers had charted a strategic modernization plan of all their facilities. They had indeed built after the war, but today the average age of a German steel plant is 10 to 15 years old. The modernization was predicated on the simple calculation that, in a world where industrial nations have to gear up capital investments to guarantee profitability and base their margins on high rates of productivity, and where industrialization is progressing in the developing sector, there could not fail to be a demand for high-