The international economic crisis catches up with German business

by George Gregory, Bonn Bureau Chief

West German Chancellor Helmut Schmidt customarily lectures his parliament on how much "better off" the West German economy is, in comparison to most other Western industrial economies: lower inflation, lower unemployment, more or less successful management of the 1979-80 oil-price crisis, booming exports, moderate wage increases, and so on. Nowadays, economists, including Helmut Schmidt, are asking themselves how it is possible to be so relatively "better off," with a lot of icing on the cake like a hefty export surplus, at least a balanced current account position, even slightly improved terms of trade, and still have an economy caught in zero-growth, and sinking rapidly. Memories of the horrors of the 1930s are reawakening.

The only reason why the West German economy has not produced worse headlines than those on the AEG electronics firm bankruptcy is that the West German economic system is "constipated": production has not fallen as rapidly as the rate of incoming orders would justify, nor has employment fallen as rapidly as capacity-utilization has declined. There is therefore a backup of pressure which is going to break in the coming months as reality catches up.

Given the spreading depression in the economies of West Germany's Western industrial trade partners, and financial strangulation of the country's export markets in the developing nations and Eastern Europe, the marginal export compensation for falling domestic consumption (−2 percent to 1981) and plummeting domestic investment activity (−8 percent to 1981), is evaporating. The result will be truly 1930s conditions by the second quarter of 1983 at the latest.

Over two years, the U.S. Federal Reserve's high interest rates have done the lion's share of damage to the West Germany economy. Domestically, the decline in investments is accelerating from the real drop of 5 percent last year to −8 percent this year; the rate of bankruptcies and insolvencies is continuously breaking post-war records, increasing over 50 percent from 1981 to an annual average now of over 14,000, predicted to reach 16,000. The AEG firm, ranking among the top ten West German corporations, whose name has been virtually synonymous with "Made in Germany," has filed for protection from its creditors. This biggest name among the casualties so far may yet be put through liquidation.

This firm is paradigmatic of the financial perversions proliferated by the high interest rates regime. Those manufacturing firms which most successfully transformed themselves into coupon-clipping insurance companies financially are the best positioned to survive a few more years. Daimler Benz, which produces Mercedes cars, earned more on interest (1.3 billion marks) than on the sale of its cars. AEG, by contrast, paid out more in interest (700 million marks) than its total equity of 650 million.

A Brazil-style export boom

The greatest misallocation of financial resources occurred over 1981, amid an export "boom" which halved the current account deficit to a mere 17 billion marks. After the 1980 deficit, word went out to the exporting economy that "adjustment to world economic realities" meant that expenditures for raw-materials, oil, and heavy foreign transfer payments had to be balanced out at any price. Industry exported its heart out, quite literally. Fully one-third of export contracts were booked, consciously, at below cost, at a point when customers were quite willing to buy on the back of a cheap mark. Another third of export contracts broke approximately even, and the remaining third scored moderate earnings. The alibi for this boom—Brazilian style exporting of everything not nailed down—was the illusory hope for more profitable follow-up contracts. That hope also justified maintaining levels of employment and capacity utilization, even though it was plainly evident, at least by the turn of the year, that a continuation of the worldwide exorbitant level of interest rates would collapse world trade. For that one year West German industry paid its bills, and achieved a 24 billion mark surplus on trade. In the first seven months of 1982, the trade surplus went to 28 billion, and last year's deficit to OPEC of 5 billion has turned into a surplus of 4 billion.

The alibis are now gone, the follow-up contracts are not forthcoming, and new business is scarce. As of the first quarter, exports were rising in real terms by 12 percent, but by the second quarter the rate of growth was down to 5 percent, and in volume actually below the first quarter. Exports in July were 5 percent below July 1981, and 5 percent below June 1982. Total production had already dropped in June by 3 percent below May levels. Production in the first quarter had been maintained, fortunately, at the level of stagnation, thanks to accelerated fulfillment of contracted orders. Total orders on the books dropped from the 1981 peak of 4.8

months of production in May to 4.6 months, and to 4.4 months in June.

The machinery section is perhaps most graphically illustrative. Assuming an average 6 month lead-time on machinery/capital goods investments, the current rate of incoming orders shows that the West German economy will be in an investment-depression by the beginning of 1983. Total orders for machinery dropped in the first half of 1982 by 10 percent, but the decline was accelerating to − 14 percent in the second quarter. Real sales were stagnant at 1 percent, due solely to fulfillment of foreign contracts at a 6 percent rate, while the domestic sales dropped by 5 percent. However, in the all-important investment-flagship sector of machine-tools, real sales were down by 9 percent, led by the collapse of domestic orders for machine-tools by 18 percent. Foreign orders for machinery dropped by 9 percent.

The rate of short-work in the machinery sector has already doubled from last year's level to 80,000 persons, 8 percent of the workforce, and the association of German machinery manufacturers has pre-announced that both short-work and lay-offs will escalate for the rest of this year. Capacity utilization here had dropped from 84 percent at the end of 1981 to 80 percent at the end of the first half of 1982, while overall industrial capacity utilization has fallen from 78.5 percent to 77 percent from the first to second quarters.

Unemployment on the rise

Combined with Paul Volcker's interest rates, and the all-too-great willingness of the German Bundesbank to ape him, West German industry and trade-unions now bear the brunt of the costs forced upon them by their domestic "post-industrial society" opponents. The national average unemployment is now 7.5 percent, but in the industrial heartland of the Ruhr it is over 10 percent, and in some cities over 18 percent. As the Chambers of Commerce of Ruhr cities stated flatly in a recent report, the primary problem of the Ruhr and other industrial centers of the country is "the generally characteristic deindustrialization process in the economy of the Federal Republic of Germany."

That fact is most evident in the amazing phenomenon that industry in this area of highest industrial concentration in the world utilizes not one kilowatt-second of electricity produced in a nuclear reactor.

The flip side of that coin is the deindustrialization of the workforce. Quite significant increases in unemployment among skilled layers of the workforce have taken place since Paul Volcker took office. Compared to 1979, 85.5 percent more skilled chemical workers were unemployed at the end of 1981; 143 percent more machinists, 78.9 percent more electricians, 27.6 percent more construction workers, 58.3 percent more engineers, and 54 percent more technicians in various professions. Since 1979, the rate of unemployment has increased by 70.5 percent to the end of 1981, and, as remarked above, is now 41 percent higher. There are now 15.8 teachers for every job available.

Several months ago, the Association of German Industry did a poll of members to determine the volume of investments blocked by environmentalists, courts, and government officials like Interior Minister and Free Democrat Gerhard Baum. Only one-third of the members were courageous enough to answer in detail, and the other two-thirds said that they feared special retaliatory action would be taken by militant environmentalist groups were they to draw attention to their projects. One third of the membership of the Association was nevertheless able to account for over 30 billion deutschemarks in incompleted or never-started investments. Multiplying by three, it is generally agreed, results in the most conservative estimate of the economic loss involved.

Free Democratic Party Economics Minister Count Lambsdorff cut that debate short at the time, with the specious argument that most of these investments had been cancelled or postponed simply because economic growth had turned out lower than initially expected, and thus, not as a result of the investment sabotage that does exist. Since then, Lambsdorff made himself responsible for growth prognoses which foresee 3 percent growth in GNP terms for 1983, and average unemployment of 1.78 million. Lambsdorff handed that prognosis to his Social Democratic colleague, Finance Minister Lahnstein, who then proceeded to draw up a budget for 1983 on that basis. Neither will 3 percent be achieved, nor the "conservatively optimistic" current consensus prognosis of most economic institutes in West Germany of 1.5 percent; nor will average unemployment be far below 2.3 million. Each deutschemark less in tax revenues, and each one more in unemployment support, tears holes in the federal budget, such as the 10 billion mark hole this year.

Locked in as West Germany is with its export-dependency, the Chancellor's only chance to save his country as an industrial economy is to act to save export markets. On the basis of orders carried over from 1981, West German exports to the United States were still increasing by the end of the first half at 20 percent over last year, but orders are now dropping rapidly in response to the collapse of U.S. capital investment. West German exports to the post-industrial island of Britain are marginally higher than to the United States, but even Britain is contracting below its already depressed level of economic activity. France accounts for 13 percent of German exports, but as the Mitterrand government proceeds to crush the "consumer boom" there, orders from France have begun to drop, too. Imports from East European countries have increased at a rate of 27 percent as these countries scramble to earn foreign exchange to service their debt, but exports have declined at a real rate of 5-6 percent. OPEC countries account for 8.8 percent of total German exports, but with declining orders actual growth of export deliveries has declined from over 50 percent last year to barely 30 percent as of the beginning of the second half of the year. Trade with Latin America has declined especially since mid-1981, and exports to the major partners, Argentina and Brazil, are down between 15 and 20 percent.