N°26 | JANUARY 2015

ECONOTE

Societe Generale
Economic and sectoral studies department

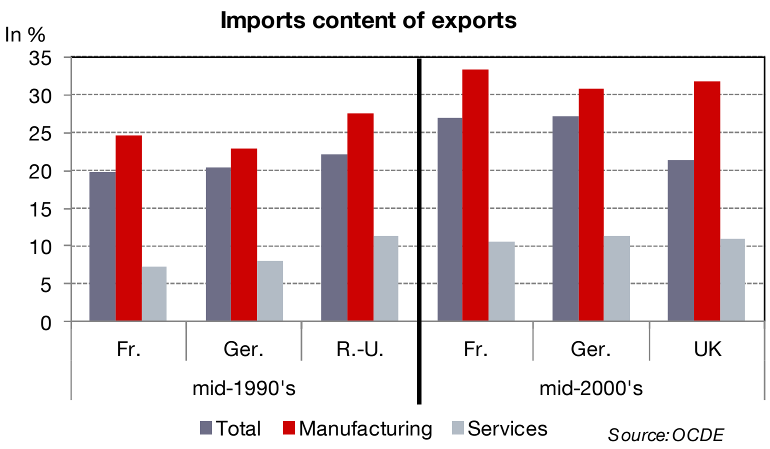
GERMANY: NOT A "BAZAAR" BUT A FACTORY!

— Germany's export performances since 2000 have stood out significantly from those of its main neighbours, with much healthier trade balance, exports and export market share.

— The argument often put forward of lower production costs in Germany, primarily due to better contained wage costs, does not seem to be the only explanation for Germany's better performance.

— Neither, as has been suggested, has Germany changed into a "Bazaar economy" that would mainly re-export goods largely produced abroad, notably in Eastern European countries. In fact, the imported added-value content of German exports is not different from that of the United Kingdom or France, once products composition is taken into account.

— The point on which Germany does stands out very significantly, however, is that it has not undergone a process of de-industrialisation over the last 20 years, unlike its main neighbours.



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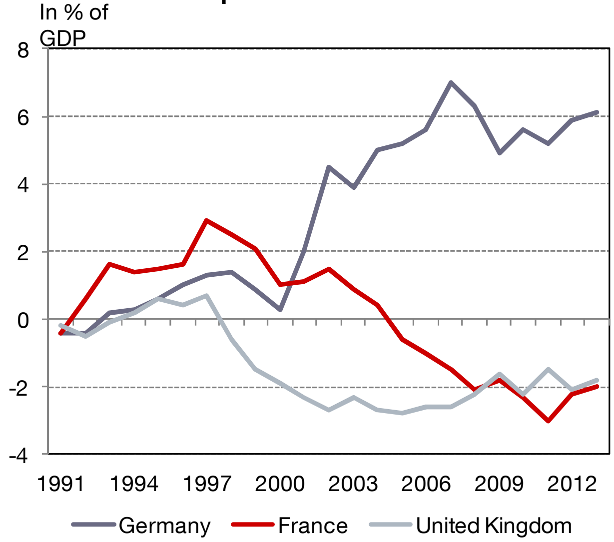
SOCIETE GENERALE

GERMANY: AN EXPORTING MACHINE

SUBSTANTIAL INCREASE IN TRADE SURPLUS SINCE 2000

At the beginning of the 1990s, just after its reunification, the German economic image was not very different from that of France or the United Kingdom in terms of foreign trade. In particular, its trade balance was virtually at breakeven, which was also the case for the other two countries. Moreover, the share of exports in the economy was also at a comparable level. And even in the years that followed, the trend in France's balance of trade was more favourable than Germany's.

Graph. 1: Trade balance



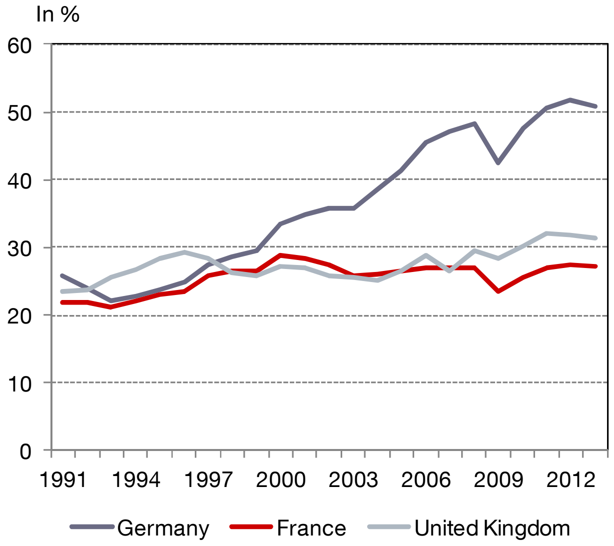
Source: Eurostat

However, there has since been a considerable change in the situation, resulting in Germany standing out sharply from its two main neighbours. Accordingly, the German trade surplus has increased substantially during the 2000s, reaching around 6% of GDP since 2006 (see graph 1). At the same time, France and the United Kingdom have experienced a lasting trade deficit, of around 2% of GDP. Compared with France, the divergence in trajectories is even more marked if we look at the situation since the middle of the 1990s: whereas Germany saw its surplus rapidly increase, France saw its surplus shrink (it amounted to nearly 3% of GDP in 1997), before turning into a deficit from 2005.

EXPORTS REPRESENT AN INCREASING PART OF THE COUNTRY'S ECONOMY

This increase in the German surplus has been underpinned by an export boom. We have also observed in France and the United Kingdom a trend towards growing foreign trade flows, but there is no possible comparison with Germany. German exports have gone from 20-25% of GDP in the early 1990s, i.e. comparable to that of France or the United Kingdom, to around 50% nowadays (see graph 2), whereas these two other countries have only reached a ratio of around 30% of their GDP.

Graph. 2: Share of exports in GDP



Source: Eurostat

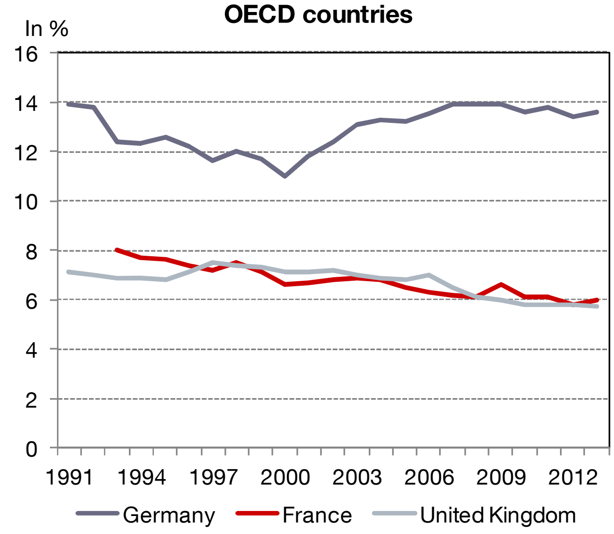
GERMANY HAS MAINTAINED ITS EXPORT MARKET SHARE

The result of these diverging trends is that whereas France and the United Kingdom have seen an erosion in their export market share of among OECD countries[1], Germany has succeeded in maintaining its market share and even regaining ground lost during the 1990s (see graph 3).

When we break down foreign trade, we observe that Germany has not only succeeded in maintaining its market share in the export of goods, but has also slightly increased its export market share in services.

[1] *It is normal for developed countries to see their weight in world trade decline given the increasing momentum of emerging countries, both as exporters and import markets. Comparing market shares in relation to other OECD countries is a means of correcting for this structural trend.*

Graph. 3: Exports market share among OECD countries



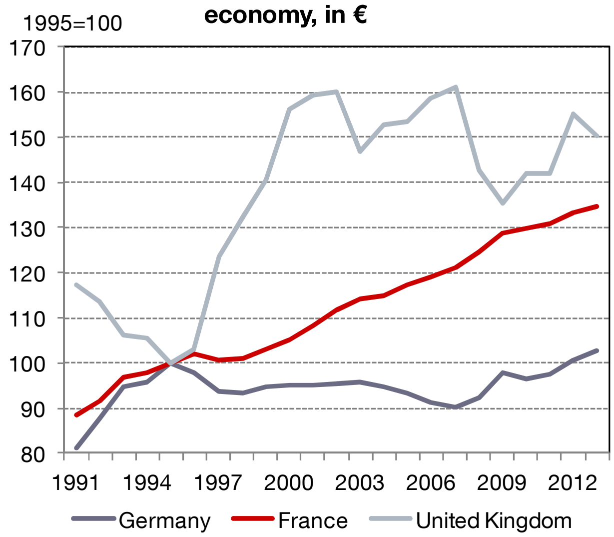
Source: Eurostat

EXPORTS THAT COME FROM IMPORTS, BUT NO MORE SO THAN FOR ITS MAIN NEIGHBOURS

COMPETITIVENESS ALONE CAN'T EXPLAIN GERMANY'S PERFORMANCE

In order to explain this atypical performance by Germany, a possible explanation is that German exporters have become more competitive, primarily due to wage moderation and labour market reforms (including the famous Harz reforms between 2003 and 2005).

Graph. 4: Unit labour costs, whole economy, in €

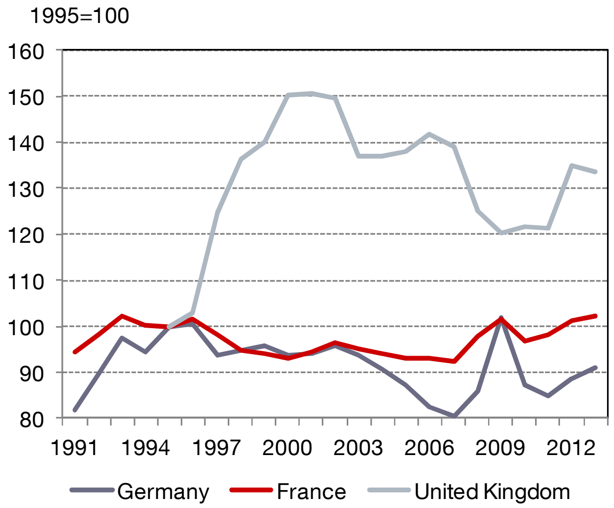


Source: Eurostat

This explanation is based on the observation that, notably since 2000, German unit labour costs[2] have experienced a more favourable trend than those of its neighbours (see graph 4). They actually decreased between 2000 and 2007, whereas in France, for example, they rose by 15%. And it is precisely from 2000 that the German trade surplus started to grow strongly, as did the share of exports in Germany's GDP.

However, it is important to put this argument into perspective. Firstly, this divergence in unit labour costs actually started several years earlier in 1995. Subsequently and more importantly, when we focus on the sole manufacturing sector - which is more directly exposed to international competition - the difference between France and Germany is much less marked (see graph 5). Furthermore, the divergence in manufacturing unit labour costs between France and Germany is only noticeable as from 2004, i.e. after most of the divergence in trade balances and market share had already occurred.

Graph. 5: Unit labour costs, manufacturing sector, in €



Source: Eurostat

THE WEIGHT OF GERMAN IMPORTS HAS INCREASED SHARPLY IN PARALLEL WITH THE ONE OF EXPORTS

Another explanation put forward, notably by the President of the German IFO institute, Hans-Werner Sinn[3], is that Germany's export performance concealed the country's transformation into a "bazaar economy". According to this explanation, Germany capitalised on

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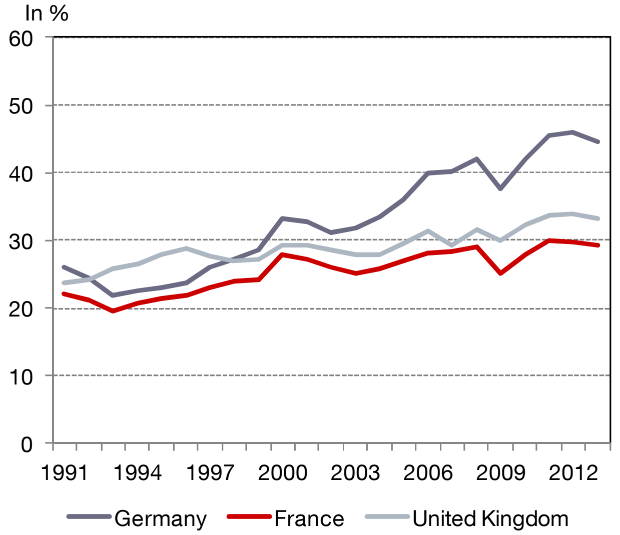
[2] *I.e. the ratio of total labour costs, including employee and employer social contributions, to real added value.*

[3] *"Die Basar-Ökonomie. Deutschland: Exportweltmeister oder Schlusslicht?", Hans-Werner Sinn, October 2005.*

the fall of the "iron curtain" and then the extension of the European Union eastwards to increasingly push the integration of its production chain sites based in east Europe in order to benefit from lower production costs. The result has been a rise in German exports, but at the price of a parallel increase in imports. Ultimately, according to this explanation, the surge in German exports is primarily due to the re-exporting from Germany of products manufactured abroad and then integrated into the German production chain. In other words, the German export performance would not be explained by domestic wage moderation but foremost by an important and increasing use of cheap imported contents. Furthermore, the increase of the exports market share would be partly misleading, due to the weight of re-exported imports. This argument would also explain why the German export boom has been less beneficial to employment and wages in Germany than in the past.

In support of this explanation, we can observe over the same period a substantial rise in the share of imports in Germany's GDP, in parallel with that of exports, and much more marked than in the case of France or the United Kingdom (see graph 6). Moreover, German domestic demand has been particularly sluggish: it has risen by an average of only 1% per year whereas, at the same time, it rose by 1.5% per year in France and 2.5% per year in the United Kingdom.

Graph. 6 : Share of imports in GDP

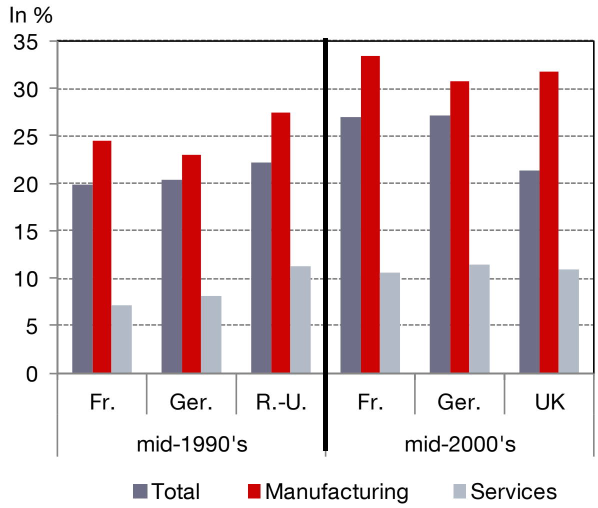


Source: Eurostat

However, the import content of German exports is no higher than elsewhere

According to this explanation whereby Germany has turned into a "bazaar economy", we should witness a growing proportion of inputs manufactured abroad, and particularly in Eastern European countries, included in German exports. And in fact, OECD calculations reveal that the imported added-value content of German exports (i.e. the share of activity related to German exports that actually took place abroad) increased significantly between the middle of the 1990s and the middle of the 2000s. Indeed, the share rose from 20% to 27% in a decade (see graph 7).

Graph. 7: Imports content of exports



Source: OCDE

That said, this trend should be put into perspective. It is very similar, and even slightly less marked, to the trend observed in France. However, in contrast, it is noticeable that the proportion of foreign added-value included in exports has decreased slightly in the United Kingdom. Yet this is entirely due to a difference in the structure of German and UK exports: when we break down exports by sector, German exports of manufactured goods have a slightly lower import content than those of the United Kingdom while exports of services have a comparable imported content.

All in all, it emerges that there has been no specific dynamic in the imported added-value content of German exports, which runs counter to the explanation of the "bazaar economy". Admittedly, it has benefited from the greater integration of Eastern European countries within its production chain but, compared with France or the United Kingdom, this has not been at the expense of the "Made in Germany[4]" content of its exports.

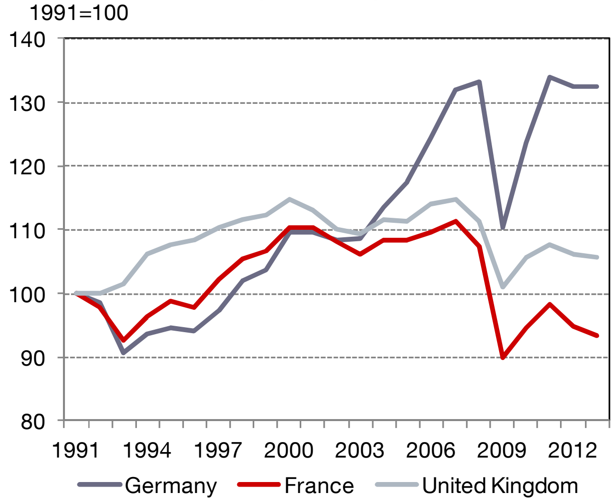
Germany has managed to maintain its industrial base, its export driver

The unique features of the German export machine stem from the strength of its manufacturing sector. Manufacturing production has been much more

[4] *In Deutschland hergestellt*

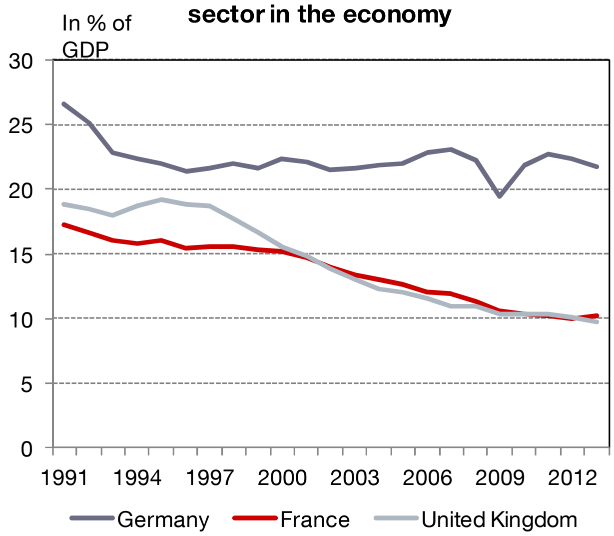
dynamic in Germany than in France and the United Kingdom in the 2000 decade. As a result, the share of the manufacturing sector in the German economy has been relatively stable over the last twenty years, whereas it has been virtually halved in France and the United Kingdom (see graphs 8 and 9). Consequently, manufacturing's share of GDP is now more than twice in Germany than in France and the United Kingdom.

Graph. 8: Manufacturing production (in volume)



Source: Eurostat

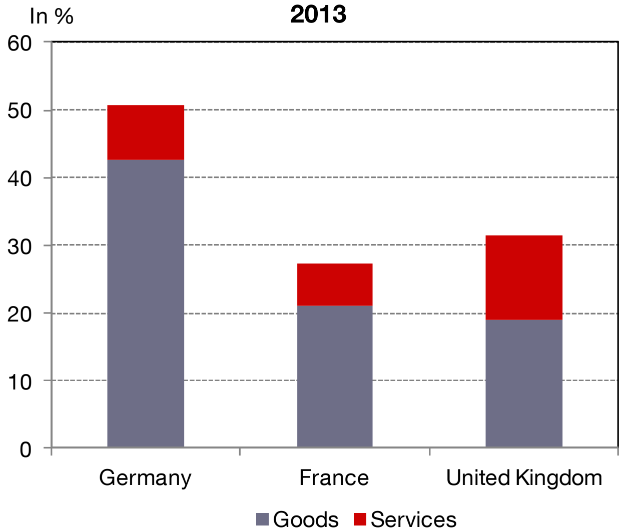
Graph.9: Share of the manufacturing sector in the economy



Source: Eurostat

This difference can also be seen in Germany's foreign trade. Exports of goods amount to nearly 40% of German GDP, compared to half this share in France and the United Kingdom (see graph 10). It is worth noting the particularly high share of exports of services in the case of the United Kingdom.

Graph. 10: Share of exports in GDP, in 2013



Source: Eurostat

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