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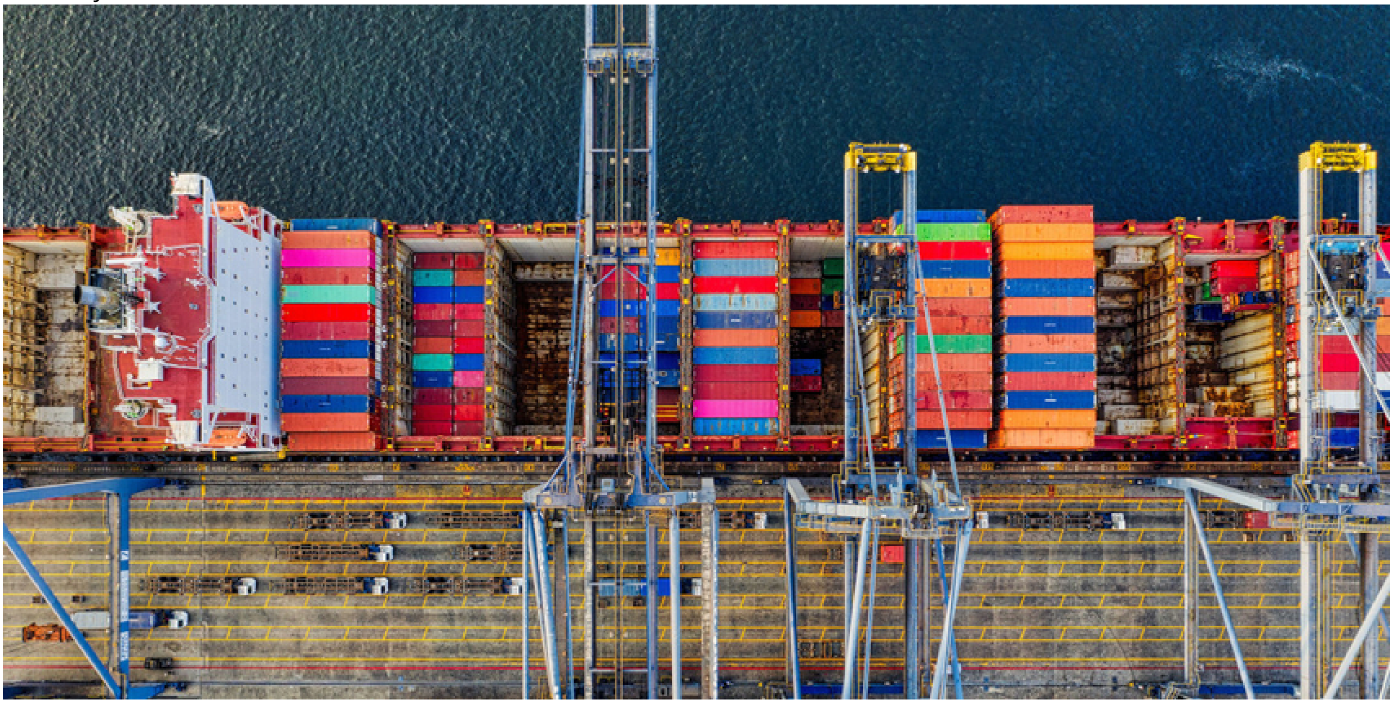
The extreme German export model and the financial sector

In several respects, the German financial sector is one of the victims of the increasing export orientation of the German economy



This blog post was contributed by Benjamin Braun, Senior Researcher at the Max Planck Institute for the Study of Societies in Cologne, and Andreas Nölke, Professor of Political Science at Goethe University in Frankfurt and SAFE Fellow.

During the Corona crisis, the stabilizing role of German exports is often emphasized because of the collapsing economic performance in many local service sectors. Compared to other large economies, Germany stands out with a far disproportionately large export sector. In 2020, Germany's export ratio was 43.5 percent of economic output, much higher than in other large economies such as the UK (29.3 percent), France (27.4 percent), China (18.4 percent), Japan (16.4 percent), or the USA (12.9 percent). It has also increased sharply over time, from 15 percent in the early 1970s.

Now, there is nothing wrong with a high export volume, especially if it is based on low-price-sensitive and research-intensive high-quality goods. For decades, however, German industry has been moving toward a model in which exports are increasingly generated less by cutting-edge technologies and more by price-sensitive, yet high-quality goods. Particularly for the first decade after the millennium, the Organization for Economic Cooperation and Development (OECD) notes a significant tendency of the German economy to achieve its export success chiefly via price competition and only secondarily. through product quality.

Clear disadvantages in the orientation of the German economy

This orientation of the German economy entails clear disadvantages. A high share of price-sensitive exports makes it necessary to keep wage-price dynamics low, including via weak domestic demand and subdued mortgage lending to private households. There has been considerable wage restraint in Germany in recent decades, especially compared with some other members of the euro area. The price competitiveness of the German economy compared with its trading partners has improved significantly since the mid-1990s. At the same time, the German economy has benefited from more generous lending in other economies and the resulting demand for German goods, especially before the global financial crisis.

That said, a chief victim of Germany's increasingly extreme export orientation has been the financial sector. For example, in contrast to many neighbouring countries, Germany hinders the granting of real estate loans through a wide range of measures from real property transfer tax and notary fees to high equity requirements.

Crucial to the impact of the German export model on the financial sector are the unusually high profits achieved by German companies, mainly thanks to moderate wage growth over the past 25 years. As a result, investments could be paid for effortlessly from retained earnings. Banks were therefore much less needed as providers of capital for corporate loans. In contrast to all other major European economies, borrowing by (non-financial) companies have declined significantly since the mid-1990s. In addition, there were shifts within corporate borrowing. The share of domestic bank loans in companies' remaining debt fell from 75 percent to 50 percent over the past three decades, especially in favour of foreign banks and bonds.

Better balance between export and domestic demand

The major German banks saw the biggest fall in their market share in corporate loans – savings banks and credit unions performed better – and had to look for an alternative business model. They found a new role in the proprietary trading of financial products and in investing the capital accumulated by exporting companies and their owners. Both were much riskier than traditional corporate lending at home – and not overly successful, as can be seen from the state of Deutsche Bank and Commerzbank, not to mention the wound-up Landesbanks and Hypo Real Estate, or even the Düsseldorf-based IKB. A return to the "Deutschland AG" of the early and mid-20th century is illusory.

At that time, the legendary main banks worked closely and on a long-term basis with the companies they served, often also as anchor shareholders and with prominent representation on the supervisory board. The German banks have since sold their industrial holdings, and German companies will not want to miss the existence of alternative sources of financing. Nevertheless, it would also be in the interest of the German financial sector to improve the balance between foreign and domestic demand for our economy. Such a rebalancing via higher wages and government spending would not only help workers and beneficiaries of improved infrastructure but also German banks via increased demand for credit.

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Leibniz Institute for Financial Research SAFE

Theodor-W.-Adorno-Platz 3
60323 Frankfurt am Main

Phone: +49 69 798 30080
Fax: +49 69 798 30077
Email: info@safe-frankfurt.de

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