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BPRIME MINISTER

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GERMANY: A PERSONAL VIEW

During the last recess I spent a few days in the Federal Republic as the guest of the Konrad Adenauer Foundation. I talked with numerous officials, politicians, businessmen and researchers, and as on my previous visit, came away with some strong impressions.

1 The German Economy is Strong and Europe-Oriented

Real growth in Germany at present is strong. Between 1985-7 real GND growth averaged 2%. Deutsche Bank's estimate for 1988-90 are:

	1988	1989	1990
Germany	<u>3.4%</u>	<u>3.0%</u>	2.8%

The present boom is driven by investment and exports but not by consumption.

The current demand for new capital is not to rationalise and introduce new production processes which it was a few years ago, but to expand capacity to meet the growing internal market. The growth in exports reflects the investment growth in other European countries, and has occurred particularly in machinery, machine tools, electrical goods and cars (involving companies such as Mannesman, Siemens, Thyssen, Bosch, BMW and DaimlerBenz). Both the growth of exports and of the economy reflect a very strong manufacturing sector.

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The strength of the economy is reflected in a growing and seemingly permanent balance of payments surplus (Chart 1). This has involved growing surpluses with other EEC countries over the past few years.

GERMAN TRADE SURPLUS

(DM billion)

	<u>1986</u>	<u>1988</u>
EEC Countries	51	80
UK	15	22
France	15	18
Italy	5	11
Netherlands	-2.3	+3.7

By contrast to the growing trade with other European countries, trade with the US has fallen.

2 The Economy Remains Strongly Corporatist, with only Feeble Attempts at De-regulation and Privatisation

The "social market economy" remains a revered institution by politicians, officials and even free-market economists. They accept that co-determination (involving trade union participation in the running of all large firms), the large benefits companies pay employees, high minimum wages and the elaborate training they provide are all costly, but believe they buy long-term industrial peace. The strike by the metal workers a few years ago is considered the exception. They



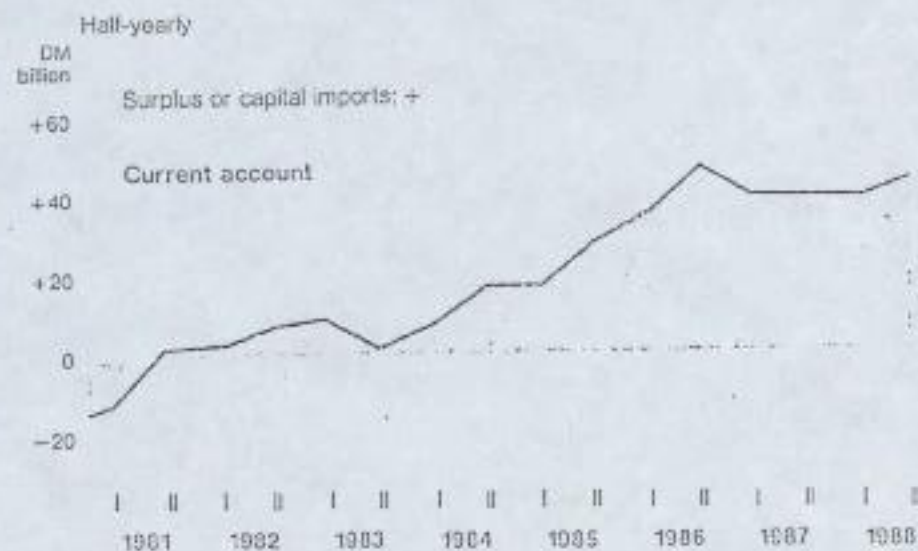
CHART 1

GERMAN BALANCE OF PAYMENTS SURPLUS

DM billion

	1981	1982	1983	1984	1985	1986	1987	1988
Trade Balance	+39.4	+63.3	+57.0	+65.8	+84.7	+121.9	+126.1	+138.6
Current Account	- 8.0	+12.4	+13.5	+27.9	+48.3	+ 85.1	+ 81.2	+ 85.2

## Balance of payments pattern



1) Including balancing item of the balance of payments. - 2) Change in the net external assets of the Bundesbank resulting from transactions.

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accept that because of the social market, the German economy cannot respond quickly to change, but they argue that in return it gives the economy great power, because when they then move in a certain direction, everyone is together.

No one I talked to was interested in the laws on co-determination being changed. One reason industrialists and banks are keen on it, which they were coy to discuss, is that it is also a strong disincentive to take-overs of German companies.

Among some economists, however, there is a recognition that the economy is over-regulated, that there is too much public ownership (especially at the regional level), and that attempts at privatisation and de-regulation have been feeble eg:

- the one really successful de-regulation has been broadcasting;
- but the PTT is not only not being privatised but de-regulated by simply being split up into three operating companies;
- de-regulation of shopping hours (which are at present very rigid) has been discussed for the past three years: the result is that shops may stay open for three more hours on a Thursday evening;
- the major attempts at privatisation have been little more than selling government shares in Volkswagon, Lufthansa, etc; they have not been impressive in terms of changing attitudes;
- subsidies to shipbuilding, steel and coal, railways and other transport remain uncomfortably high;
- standard annual working time in manufacturing is just over



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1700 hours in Germany, compared to 2,200 in Japan and 1900 in the US and Switzerland;

- laws against improper competition in the retail trade mean shop managers cannot use rebates and discounts, and entry for supermarkets is affected by regulations concerning use of downtown and suburban sites;
- craft trades (such as bricklayers, painters, joiners, tailors, butchers, printers, rug cleaners) are still regulated in a guild-like way;
- air fares on domestic routes exceed international routes by between 30-70% and long distance haulage is highly regulated;
- imported coal is one-third the price of domestic coal and French electricity is one-third cheaper than German electricity;
- the result of corporatism and subsidies is high regional unemployment in Berlin (10%), North Rhine Westphalia (10.5%), Hamburg (11%) and Saarland (12.5%) and low unemployment in Baden-Wurttemberg (5.0%), Hessen (7.0%) and Bavaria (7.5%).

The rigidity and inefficiency created by the social market economy is a major concern of, for example, Lothar Speight, from Baden Wurttemberg. Although he is from the most dynamic part of Germany, he was very conscious that Japanese investment is coming to Britain not Germany and that we had a major competitive edge over them. Robert Bosch had recently announced its largest ever foreign investment - 300 DM million in Wales.

His response, however, was very corporatist. While he would not subsidise declining industries (TV tubes, textiles, watches) he is eager to pick winners in the high-tech field and also invest heavily in universities, research science facilities (the science city of Ulm) etc.



3 The Challenge of 1992 is a Limited Increase in Competition Without Changing Labour Laws or the Commitment to a Social Market Economy.

One theme which recurred with many people was:

"We don't mind how much you wish to privatise, extend competition and reduce trade union power in Great Britain, but we must make it absolutely clear that 1992 will not disrupt the 'social peace' which prevails in German industry. 1992 is not about Britain exporting Thatcherism to Germany or to the Community."

This argument was made in the strongest possible terms. Any attempt to change labour laws affecting German industry or the structure of the German company would be seen as undermining German society. It would be resisted in the strongest possible way.

It is a view which has one very important consequence. 1992 will, from a German point of view, reduce barriers to trade between European countries. But if German industry is to bear the costs of its labour laws, company laws, the dual system of vocational education, etc, this can only be achieved if two conditions are met:

(a) first, manufactured goods produced by foreign companies which do not have these overheads, and which will, therefore, be cheaper, will have to be limited or kept out of the Single Market - there will have to be external protection by the Community;

(b) second, foreign take-overs of German companies will have

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to be discouraged - there will need to be strict limits to competition policy.

The social market economy is costly to German industry. There is no way in which it is compatible with free trade and the unrestricted ownership of equity shares in German companies. The process of de-regulation is already slow within Germany.

The only policy for Germany is to ensure that the restrictions implicit in the social charter and other social aspects of the Single Market are set at the existing German level rather than those of the more competitive countries in the world.

4 The EMS - or a DMark Area - is a way of Germany Strengthening its Dominance in Europe

The EMS gives Germany the following advantages (even though one might question some of them):

- the DM is permanently undervalued relative to the French franc and the lira - which is why there is a permanent trade surplus between Germany and other EEC countries; as in the Bretton Woods system deficit countries are always loathe to devalue and surplus countries even more to revalue; because the French and the Italians never fully compensate for wage and price inflation, there is a built-in mechanism for artificial competitiveness;

- there is the expectation that more transactions and liabilities will be denominated in DM.

- to the extent that the financial sector can be de-regulated, Frankfurt will become a more important financial centre; already there is a concerted effort to raise the profile of Frankfurt: there are 250 foreign banks there and only 150 German.



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I had a very agreeable and interesting lunch with Mr Pohl. He argued strongly in favour of the UK joining the ERM and if need be of the UK setting out its conditions for doing so. He saw very little prospect of a common currency or monetary union, a la Delors. In the foreseeable future, therefore, we will be left with the EMS as a quasi-fixed exchange rate system based on the DM.

One particular reason he was keen on UK membership of the ERM is that it would counter-balance the demand of the French to have a greater say in the running of the System (ie the Bundesbank). He said that he had effectively sidelined the Franco-German monetary council which had been set up in 1988 - the only reason the French had sought to set up this body was to get greater control over what he did!

In addition to all of this it should be said he was very sceptical of intervention in the DM/\$ market.

5 The Government & CDU gave the Impression of Being Tired and under Threat

This emerged for two reasons.

First the government itself, in the domestic area seemed bankrupt of new ideas. I had a number of discussions with the equivalent of the Policy Unit. Their argument was that tax reforms had already been introduced, there were no plans for future deregulation; education and housing were the responsibilities of the States. The only area in which they said they would be putting forward new policies was the environment. I talked with them the day after President Bush had visited the Chancellor. They were all absolutely delighted with the visit. I could not help feeling that one reason they



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made so much of SNF was to hide the empty shelves of their domestic wares.

Second, the CDU were nervous at the percentage of the polls they might lose to the right wing Republican Party and the neo-Nazi Deutsche Volks Union. Opinion polls put the likely vote of the first in the European elections at around 5% and of the second at 2%. If in the Federal elections next year they were to take votes from the CDU and if the Greens got the predicted 12% of the vote, then there could be a new Green-Red coalition government in Bonn.

6 Germany in the Community and the Wider Europe

One of the most interesting meetings was with an independent research foundation, which among other things conducted opinion surveys. It is highly thought of by government.

They started their presentation by saying that the most notable current trend was that Germany had become "Europe-tired". The elite were still very European Community minded, but the population were not any more, even though Germany had been very EEC minded in the past. They claimed that the cause of disillusion was the CAP. The EEC was associated in the German mind with inefficiency and a high cost for German taxpayers.

Support for a European currency had dropped dramatically. In the mid-70s, 54% supported an EEC currency. Over the past three years that figure had dropped to 20%. This was a view held by both young and old.

There was not much trust in the European Community or European policy; but there was a good deal of confidence in Germany and German policy. The DM was held in the greatest possible



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esteem largely due to people's personal experience of travelling abroad.

It was this feeling for Europe which had led the CDU to run an election campaign in the European elections based on national rather than European issues.

This loss of confidence in the Community was accompanied by enormous admiration for Mr Gorbachev and the hope of a larger Europe. The population were now in favour of disarmament without any conditions. This was again a major shift in public opinion. The answer 'yes' was given to the question "Could disarmament lead to less security?" by only 25%. A neutralised Germany was seen as the price of a significant move toward re-unification.

Throughout the 1970s never more than 25% of the population had expressed such a sentiment on re-unification. Over the eighties, however, the figure had risen and now stood at 40%. If asked the question "Should Germany leave Nato?" the answer was 'no'. But if this was linked to re-unification, then it became 'yes'.

The major opinion leaders had been the Greens - two-thirds of their supporters are below 30 years old. They are not a single issue party but have predictable attitudes on a whole range of issues: East-West, US, women's issues, nuclear energy, high tech issues, large companies and finances.

#### Conclusion

Germany is undoubtedly a strong economy with an impressive industrial base, which is artificially competitive because of the EMS. They are clearly envious, however, of the underlying competitiveness and dynamism of the British economy.



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Their strategy within the Community will be to impose the social market economy on all countries in order to increase their competitiveness. They are proud that the DM is the foundation of the EMS and would dearly like to capitalise on it.

In terms of politics and national sentiment, I detected a noticeably different attitude from when I was last there. It was as if they had come of age, possessed a growing confidence and wanted to express themselves in their own way, "do their own thing.". At most social occasions the conversation would invariably turn to Germany's responsibility to the countries of East Europe, and the possibilities of some enlarged federal structure - but invariably copying that of the Federal Republic - in which sovereignty would be shared, and in which they could help those with whom they shared much if not most - the people of East Germany.

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