



EAST GERMANY'S INTERNATIONAL ECONOMY

The vulnerability of an increasingly complex international value creation that is mainly focused on efficiency, became very evident for a majority of people this year. In April 2020, the entire German export decreased by 30% compared to the previous year. This affected East Germany as much as West Germany. However, due to its lower participation in international value chains, the economic consequences are considered to be smaller for the East. How international is East Germany? What challenges do the small and medium-sized companies face, especially now, when it comes to international trade and what opportunities are emerging despite corona or perhaps because of it?

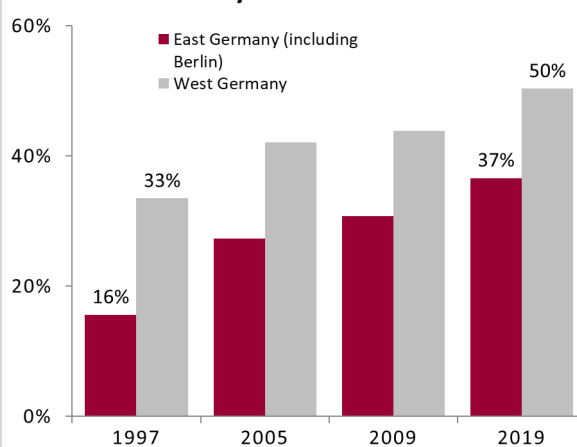
East Germany's exports

30 years after the reunification, East German products are in demand throughout the world. It was a long road to this point. With the end of the GDR and the loss of the then-existing markets, the export business collapsed abruptly. Only in the second half of the nineties it started to look up a bit.

The share of exports shows a considerable amount of unused potential

The export ratio, which is the non-domestic turnover compared to the overall turnover, improved steadily (*see graph*). Its share increased from 16% in 1997 to 37% in 2019. Yet, this percentage is far below the West German export ratio (50%). Moreover, the gap between both parts of the country has been fairly constant over the past few years. One reason for this might be that catching up is always a long and difficult

Share of exports in the industrial sector: Comparison of the development between East and West Germany



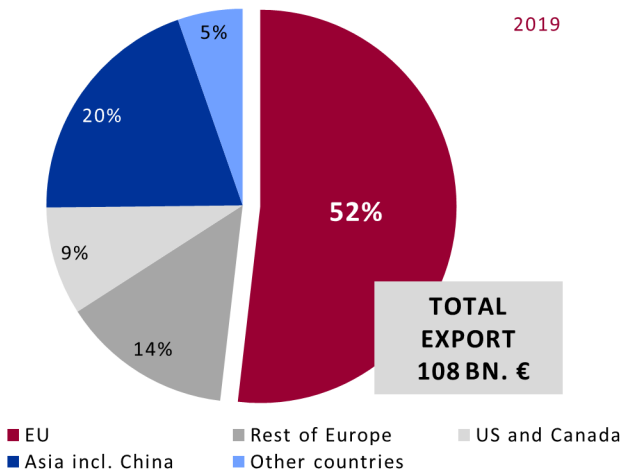
East German Banking Association e.V. (Source: Federal Statistics Office, Genesis annual report, "Employees/turnover in manufacturing sector")

process, since the other federal states (Bundesländer) also keep developing. Another important reason that these statistics often overlook, however, is the involvement of East German companies in exports via their supplier function. Thus, they indirectly participate more than the share of exports shows. Be that as it may, there is still a considerable amount of unused potential.

Important trading partners

Looking at the top ten trading partners of East Germany (*see graph*) China is number one with exports in goods worth 10.5 billion euros, followed by the United States, Poland, France and Great Britain. China replaced the United States in 2018, measured in absolute numbers, as a main exporting country, whereby the increasing exports

East Germany's export: globally successful | Main trading partner is the European Union



TOP 10 TRADING PARTNERS	
China	9,8%
United States of America	7,8%
Poland	7,4%
France	6,1%
Great Britain	5,9%
The Netherlands	5,1%
The Czech Republic	4,8%
Italy	4,5%
Austria	4,1%
Spain	4,0%
TOTAL	59,6%

East German Banking Association e.V. (Source: Federal Statistics Office, Genesis database: external trade 2019, data pulled: 15.09.2020; Rest of Europe incl. Great Britain, Russia, Turkey; East Germany incl. Berlin)

from Saxony to China play a key role here. At the same time the trade between (East-)Germany and the US has stagnated for some time now. Rising protectionism and a more unpredictable political climate in the United States increased the market risks for the country. This will further lower the attractiveness of the US market in the future, especially for East Germany's small and medium-sized companies. The fundamentally most important market for East Germany, however, is the European single market.

EU remains most important market

Challenges

Even though the exporting business of local companies increased over the past 30 years, there are – even without the corona pandemic – challenges that complicate the path abroad.

One often mentioned cause of lower export numbers is the small-scale company structure in the East, even though the IAB Establishment panel shows, that the share of small-scale companies in the East and in the West of the country is similarly high (almost 2/3 of the businesses in Germany have less than ten employees). However, looking at the numbers of big companies (more than 250 employees) one can see a clear difference in the share of employees working for these companies.

In East Germany the share is 23%, in West Germany it is 30%. Furthermore, bigger companies in the West are considerably larger than bigger companies in the East. This results in specific disadvantages for the export. Studies show that notably bigger companies are usually more productive than the average and more capable of tapping into external markets. They are able to realize economies of scale and often enough have a better capital base which allows them to finance the initially high fix costs of going abroad. Moreover, bigger companies usually have more resources for research and development, leading to more competitive products which are essential in the world market. In addition, the industrial sector, which is the strongest export sector in Germany, has a lower weight in the East than in the West (15% versus 23% share of the GDP).

Further challenges for local businesses are the following: lacking inhouse expert knowledge and lacking information or knowledge about external markets. Moreover, companies complain about immense bureaucratic requirements. Major prerequisites to go abroad are government instruments to promote foreign trade and the financing of international trade by banks. 70 and 80 percent of the interviewed people of our poll TrendOst 2020

Bureaucratic requirements are an export hindrance

consider these elements as especially relevant for moving forward with foreign trade. Hence, banks are important partners for small and medium-sized companies when it comes to realizing international business. According to our TrendOst it is encouraging that a majority of the respondents seem to be satisfied with both instruments. Measures to promote foreign trade from the federal states apparently get more goal-oriented, yet, they could get even more tangible.

Last but not least, the internationalization especially in the goods market lost its dynamic after the financial market and economic crisis in 2009. In addition, there is a colder political climate, shown by rising tariffs, increasing trade disputes between the US and China and of course the Brexit. Along these lines one talks about the peak in globalization, claiming economic ties and trade linkages have reached their peak.

And then Corona came along

The pandemic happened at a time where world trade was weaker anyway and where East Germany still struggled with (structural) challenges. *Corona intensifies transformation processes* Thus, the corona-crisis and subsequently the fast-economic collapse intensified current transformation processes significantly.

The impact of corona can be seen when looking into some sectors: The automotive industry for example - which generated in 2019 in East Germany an export value worth of about 22 Bn. Euro and accounts for one-third of saxony exports – had huge problems with a plunging demand worldwide and value chain interruptions. In July 2020, the East German construction and mechanical engineering sector registered a decline in orders from abroad by 30%. However, there are also some positive news. Mecklenburg- Western Pomerania (which is usually last when it comes to export rates) was able to boost its exports: In the agricultural and foods economy there was a plus of 36% for the first half-year of 2020.

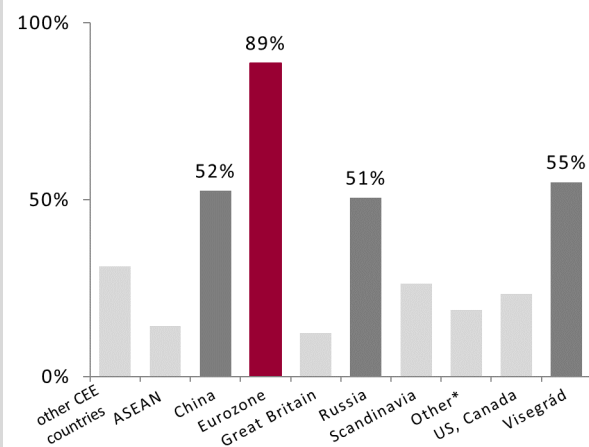
Corona also showed us drastically the vulnerability of international value chains. Current economic discussions often revolve around three possible scenarios that might occur as results of prevailing problems in international trade: Diversification of value chains and sales markets; nearshoring, thus, a stronger role of regional partners and last but not least, renationalization or localization of trade. The first scenario would not really impact the degree of globalization, the latter two come with shorter value chains and lower international dependencies, however, they reinforce risks of local dependencies and they will decrease the worldwide growth in productivity in the long term.

The question arises how the industries of today want to cope with the world of tomorrow, what this means for East German regions and if there are chances that emanate from it.

Hopeful glance into the future

It is out of question that international division of labor is a guarantor for growth and prosperity. Consequently, the goal of political economic decision-making should be to design a more resilient international trade environment. Especially the EU single market, as our shared economic area, has to be strengthened. Very fast it became evident how fragile the single market still is indeed and

In your opinion: What are important trading partners for East German states in the future?



East German Banking Association e.V. (Source: Own survey, August 2020, 202 responses, multiple choices possible, other incl. Central and South America, India, Africa)

how fast the (European) countries fall back into protectionism. Germany and the European Union have to reinforce the framework conditions of free and rule-based international competition. Bilateral trade agreements should be accelerated Strengthening of free and rule-based international competition as political mandate further and the World Trade Organization needs to be strengthened. Ultimately, it is the task of politics to address the opportunities and benefits of international trade more vigorously towards its citizen and entrepreneurs.

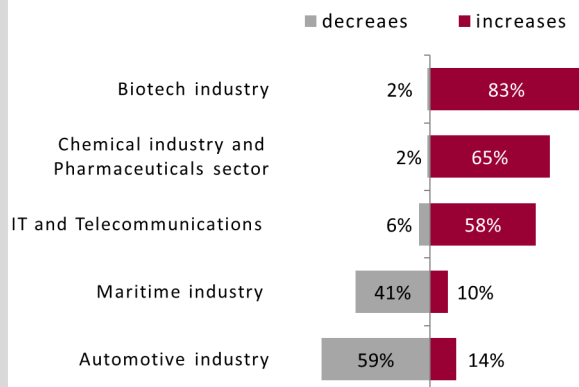
Moreover, (unrealized) further potentials for trading partners in Middle and Eastern Europe should be evaluated. Our recent TrendOst underlines their growing importance (see graph). Already in 2019, the East German export to Poland and the Czech Republic made up 12% of the total exports. The benefits Eastern Europe as important trading partner of our Eastern neighbors are obvious: Their regional proximity is quite important for going abroad, since it lowers transport and market access costs substantially, which is especially helpful for small and medium-sized companies. Last but not least similar economic, political and cultural conditions make relevant activities abroad easier.

Looking at future-oriented industries, East Germany can take a leading role. Especially in the Biotech, IT, Telecommunications and Chemical industries one sees further opportunities for inter-

nationalization (see graph). Already existing excellence cluster in these sectors are helpful to realize future potential. Additionally, the recovery and stimulus packages of the German government with their focuses on innovation and investment support are steps in the right direction. These funds can not only accompany current economic structural changes, but they can also increase the export strength of the East German companies.

Besides that, the continuous improvement of the region's location factors as well as the reduction in bureaucracy remains relevant. In the medium-term, East Germany, however, needs an organic growth of its companies creating robust enterprises that have the financial means and entrepreneurial know how to successfully venture abroad.

In your opinion: How does international trade change for the following industries in the next ten years?



East German Banking Association e.V. (Source: Own survey, August 2020, 201 responses, multiple choices possible / sector selection)

THE PRIVATE BANKS' VIEW

- **East Germany's international trade has been growing over the last decades.** However, lately the energy of globalization has declined and the pandemic shows the fragility of an internationally interdependent economy.
- International trade is the foundation of our wealth. **Companies are asked to strengthen their efforts. Government strategies must become more tangible** and there needs to be a further reduction of bureaucratic requirements.
- **The private banks are a reliable financing partner to small and medium-sized companies** and support them when it comes to business processing, consultation of export financing and competent risk analysis of foreign markets.