Global Value Chains

In autumn of 2013 the Federation of German Industries (Bundesverband der deutschen Industrie e.V. (BDI)) formally commissioned IW Consult (IW Köln Consult GmbH) to conduct the study »Global Shift in Power – How is German industry faring in the globalized world«. The study clearly shows that Germany is one of globalization’s winners; however, German success should not be taken for granted.

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Guest Contribution

Thorsten Lang, IW Consult GmbH

Change is part and parcel of the economic world. A trend over recent years has been the global shift in power.

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Global economy and German exports

Record exports in 2014

BDI expects to see continued increases in exports for the current year.

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Interview

Peter Biesenbach, Bosch GmbH

As a global company Bosch is highly dependent on global value chains.

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Guest Contribution

See Change as an Opportunity

Wolfgang Tiefensee, Thuringia’s Minister for Economic Affairs, highlights the importance of the economy being open to change.

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TTIP

The BDI calls for cross-industry rules of origin

Including cross-industry rules of origin in TTIP could reduce transaction costs and counteract divergent trade regulations.

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Global Economy and German Exports

Global economy weaker of late, despite falling oil prices

Despite geo-political tensions in the Ukraine and the Near East, the world economy gained momentum in the third quarter of 2014. According to the Netherlands’ Bureau of Economic Analysis (CPB)’s calculations, global industrial production was 0.6 percent higher than in the previous quarter (Q2 2014: 0.4 percent). The momentum of production picked up particularly in developing and emerging nations (1.1 percent). The low price of oil, which dropped 50 percent in US$ in the second half of the year, acted as a stimulus for global economic activity. In November, however (latest available figures), industrial production hardly increased at all compared to the previous month (0.1 percent). According to the International Monetary Fund (IMF), global economic performance increased in 2014 by 3.3 percent over the previous year. In 2015 the IMF is expecting economic growth of 3.5 percent, which is 0.2 percentage points less than the prognosis they made in October 2014. The difficult economic situations in China, Russia, Japan and the euro-zone were given as the reason for this revision.

According to the CPB, the 2.0 percent increase in global trade in the third quarter represented a marked acceleration compared to the previous quarter (Q2 2014: 0.8 percent). Trade, however, cooled toward the end of the year and in November there was even evidence of a distinct reduction (-1.0 percent compared to the previous month). Decisive factors behind this drop in tempo were the decline in demand in Asia (-2.1 percent versus the previous month) and a reduction in imports to Central and Eastern Europe (-4.5 percent). In January RWI’s and ISL’s container throughput index – a good indicator for gauging trade activity – also pointed to diminished trade flows. Nonetheless, the IMF is expecting global trade to increase by 3.8 percent in 2015, which would be 0.7 percentage points more than in 2014.

Stable development in Europe

According to Eurostat, the euro-zone’s GDP increased by 0.3 percent in the fourth quarter of 2014 (EU: 0.4 percent) compared to the previous quarter. Germany (0.7 percent) was particularly instrumental in shoring up growth, as were countries such as Spain (0.7 percent) and Portugal (0.5 percent), which had been hit particularly hard by the previous financial and economic crisis. Italy’s economic performance did not experience any further decline. Furthermore, countries outside the euro-zone like Hungary (0.9 percent), Poland (0.6 percent) and the UK (0.5 percent) experienced above average growth. The unemployment rate in the euro-zone held constant at 11.5 percent in November where it has been since August. However, youth unemployment rose in October and November by 0.1 percentage points reaching 23.7 percent (EU: 21.9 percent). The latest economic activity indicators (BCI and ESI) published by the European Commission pointed to stable development in January. Towards the end of the year the euro’s weakness served to shore up economic activity in the euro-zone: the real effective exchange rate (compared to 39 other currencies) fell a further 1.7 percentage points in the fourth quarter. In December, inflation stood at only 0.2 percent, which meant that the European Central Bank’s inflation target did not present an obstacle to further monetary expansion in the euro-zone. On January 14th 2015 the European Court of Justice (ECJ) ruled in a preliminary decision that the European Central Bank’s controversial purchasing program («Outright Monetary Transactions», OMT) was in essence compatible with EU law. Just one day later the Swiss National Bank (SNB) unpegged the Swiss Frank’s from the euro. From as far back as September 2011 it had managed to defend a minimum exchange rate of 1.2 Francs to the Euro in order to bolster Swiss exports. On January 22nd, the ECB then decided on a program to buy up assets to the value of more than one trillion Euros. This included the purchase of government bonds by the ECB and by national central banks. The implementation of this program, which is forecasted for the beginning of March, will likely see the value of the euro drop even further. The weak euro, loosening of monetary policy, and the low price of oil all represent positive stimuli for the European economy. However, the election victory of the socialist party Syriza and the forming of a coalition government with the right-wing populists ‘The Independent Greeks’ just a few days after the January’s elections in Greece come as a serious threat to any economic upswing. Ceasing cooperation with the Troika would not only seriously jeopardize euro-zone cohesion, but also the likelihood of sticking to the path of EU reform and any economic recovery in Europe. In January, the IMF still forecasted 1.2 percent economic growth in the euro-zone for the current year (2014: 0.8 percent).

United States: Growth continues to accelerate

In the third quarter the U.S. economy grew 1.2 percent over the preceding quarter. In the fourth quarter the increase slowed to 0.7 percent. Growth in the final quarter was driven by private consumption, investment, exports and increased state expenditure. The labor market continues to demonstrate a positive trend with unemployment in January at only 5.7 percent (January 2014: 6.6 percent). In the third quarter the U.S. real estate market continued to liven up. In the third quarter there was again an increase in both the number of construction permits issued as well as in the sales of family homes. At 2.8 percent the budget deficit came in lower than expected in 2014. The collapse in global oil prices acted as a stimulus for the U.S. economy although the U.S. oil and oil shale industry is suffering due to the fall in price. The key interest rate set by the Federal
German Exports

Record exports in 2014 thanks to a strong second half of the year

According to the Federal Office of Statistics, Germany exported goods worth 1,133.6 billion euros in 2014. That was more than ever before and 3.7 percent more than the previous year. The high demand for "Made in Germany" in the second half of the year was a key contributing factor in achieving record exports. After third quarter exports soared past the preceding quarter by a very strong 2.8 percent, they managed to add an additional 1.4 percent in the final quarter.

At 5.4 percent, exports to EU member states in 2014 increased more significantly than exports to "non-Community countries" (1.5 percent). Imports rose 2 percent, leaving them only 1.7 percentage points behind exports. The foreign trade balance closed in 2014 with the highest surplus ever (217.0 billion euros). Despite the high surplus, euro-zone states continue to profit from the strength of Germany's foreign trade and remain Germany's most important suppliers. The share of German imports from euro-zone countries versus overall imports increased slightly to 44.9 percent in 2014.

Order books point to further growth

German exporters' order books continued to fill up at the end of the year. Industrial orders from abroad grew in the final quarter. Orders increased from both euro-zone and non-Community countries. Foreign demand picked up in all the main industrial groups (intermediate goods, investment goods and consumer goods).

Asia's diminishing dynamism

According to the IMF, the Asian economy grew at the slightly weaker rate of 6.5 percent last year compared to 2013 (6.6 percent). With 1.4 percent growth in the third quarter, industrial production compared relatively well to the preceding quarter (global production: 0.6 percent). In October and November, however, growth stagnated in the region and imports actually declined significantly (-0.7 and -2.1 compared to the respective preceding months). For the current year, the IMF forecasts a growth rate of only 6.4 percent.

At 7.4 percent, the most important national economy in the region, China, experienced the slowest growth rate since 1990. As recently as February the China Economic Panel (CEP) indicator, which assesses both Chinese economic development in the next twelve months as well as its current situation, showed a distinct decrease. Reasons for such sluggish development are surplus capacity in many sectors, the weak real estate market, and growing debt among others. In early February, the Chinese central bank (Peoples' Bank of China, PBoC) reduced bank reserve requirements by 0.5 percentage points (to the current value of 19.5) with an aim to stimulate lending. In January, the IMF lowered its prognosis for growth for the current year by 0.3 percentage points down to 6.8 percent.

Due to repeated reductions in GDP, Japan technically slipped into recession as of the third quarter of last year. No improvement is expected for the fourth quarter. Despite low oil prices, the Japanese Central Bank opted against any further measures to loosen the money supply in December. The IMF reduced its growth prediction by 0.2 percentage points for the current year and is now expecting an increase of 0.6 percent.

Recession looms for Russian economy

In 2014, the Russian economy was expected to grow by a mere 0.6 percent. The economy is suffering from the low price for oil and gas on the global market, from international economic sanctions, and from capital flight as a result of the Ukraine conflict. Consequently, the Ruble exchange rate has collapsed. In light of the country’s problems the government announced an economic stimulus package of 34.6 billion U.S. Dollars in January, the effects of which remain uncertain. In a recent survey conducted by the Committee on Eastern European Economic Relations (Ost-Ausschuss der Deutschen Wirtschaft) 91 percent of the German companies polled assume that the Russian economy will perform poorly in the current year. Only 15 percent of them described the state of their business as good. 78 percent say they are feeling the effects of the Ukraine crisis. The development of economic activity in Russia is heavily dependent on the course of the Ukrainian crisis and whether a solution to the conflict can be achieved within the scope of the Minsk agreements. The current IMF assessment is that the Russian economy will shrink by 3.0 percent in 2015.
German exports on an upward trend

German exports in bn of euros and trend


Good business abroad

Incoming orders for German industry from abroad by region (2010 = 100)

Source: German Federal Bank, seasonally adjusted economic data, accessed 29 January 2015.
Not all early indicators for developments in global economic activity support the hope that demand for German products will continue to increase in the current year. The World Economic Climate of the ifo-Institute shows an upwards trend for spring 2015. The OECD’s indicator (»Composite Leading Indicators «) points to stable growth in the United States and in other industrialized countries. The euro-zone is apparently showing at least slight signs of growth. On the other hand, in February the Bundesbank’s early indicator for the world economy suggests weaker global economic development.
World Economic Climate

The conflicts in Ukraine and the Near East have not subsided so far. Additional uncertainty was added to the mix as a result of the change of government in Greece. In China, economic performance did not pick up, but continued to slow. The United States remains the powerhouse of the global economy, but here too the tempo of growth could lessen during the course of the year once the interest rate is raised. Nonetheless, 2015 could offer good prospects for growth for German exports. The low price of oil and the weak euro could have a stimulating effect on global economic activity and so too on products bearing the logo «Made in Germany».

Export-oriented branches of industry are confident about 2015

Export-oriented branches of industry are starting the year in a positive mood. Industry associations are, for the most part, expecting exports to increase over the course of the year. German automobile exports are already at a high level. The automobile industry association VDA anticipates the tailwind generated by the weak Euro and low fuel prices to continue. Equally, the VCI is expecting the chemical industry’s exports to increase in 2015, even if the rate of growth is not quite as high as that of previous years. Similarly, the German electrical and ceramics industries anticipate exports to develop positively this year. German machine-builders are anticipating higher growth at least for the first quarter of 2015 in comparison to the 2014 level; the non-ferrous metals industry is expecting stable to slightly increased tonnage sales abroad.

Challenges to Export Activity

Despite the diminished dynamism of the global economy as of late, German industry is confident at the start of 2015. However, due to the highly interconnected nature of the international economy and the extended nature of global value chains, it now depends more than ever on open markets and global peace. Set against this backdrop the German economy faces great challenges in 2015:

• The Greek Government’s politics must not be allowed to further shake the confidence of European partners. The path to reform must not be abandoned half way as a result of populist policy. By applying sound economic policy and cooperating with European partners on the basis of trust Greece has every chance of significantly improving its situation.
• The high degree of internationalization and German industry’s complex global value chains show how important global free trade is to Germany. Further success at the WTO Doha Round, a speedy conclusion to the TTIP negotiations and other agreements to protect trade and investment are important elements in securing our economic wellbeing.
• The conflicts in Ukraine and the Near East are not only impacting those countries directly involved in the conflicts, but also the global economy and by extension, Germany’s internationally-focused industry. The German Federal Government and the European Union must make every effort to end the existing conflicts in the course of the year. The decisions taken at the Ukrainian peace summit in Minsk at the beginning of February have to be implemented.
• One reason for the subdued pace of growth in China is the sluggish progress of market reforms. Property has to be better protected and cooperation improved. The speedy conclusion of the agreement between the European Union and China to foster and protect investment is an important step in this direction.

If these challenges are addressed in the course of the year and the associated risks remain mitigated, the BDI’s assessment is that German exports can sustain their growth rate in 2015.
Development in the industrial sector

Automotive Industry: Exports Remain at a High Level

Last year German car manufacturers were able to raise their exports by 3 percent to over 4.3 million cars. The positive trend continued in January; adjusted in terms of working-day effects, exports exceeded those of the same month last year by 2 percent. As the year progresses, we can expect a further boost from the now weak euro and low fuel prices. The prospects for an increase in global GDP are also good. Risks to automobile exports stem from the Russia/Ukraine crisis, particularly if it were to spread further into Central and Eastern Europe. Last year, three out of five exported cars went to Europe, representing an above average increase of five percent. The most important trading partner was again Great Britain with 821,000 units (7 percent). Countries, which had been hit particularly hard by the financial and economic crisis, achieved higher rates: Italy 14 percent, Greece 20 percent, Spain 31 percent, Ireland 35 percent and Portugal 47 percent. However, the level of exports to these countries in absolute terms still leaves room for improvement. Exports to China also progressed in an encouraging fashion with an increase of 13 percent to 274,000 units.

The Chemicals and Pharmaceuticals Industry: Export Growth Expected for 2015

Chemical and pharmaceutical products from Germany were also successful in asserting themselves on the global market. Exports increased in total by 3.5 percent. Amounting to 169.3 billion euros, exports were an important pillar of the German chemical industry. After a strong third quarter in 2014, export growth let up in the final quarter of 2014, though a moderate upswing is anticipated again for the first quarter of 2015. The German chemical and pharmaceutical industry benefitted from Euro-zone stabilization, as some 58 percent of exports stay within the EU. There are also positive signals coming from foreign markets outside the EU. The U.S. economy is proving to be robust and business in Asia is gaining slightly in momentum. In light of this, German chemicals’ exports ought to increase beyond the first quarter. The rate of growth, however, will not compare with the upturns of previous years.
The Electrical and Electronics Industry: Positive Export Trend in 2014

Between January and November 2014, exports totaled 151.3 billion euros in the electrical and electronics sector, exceeding the previous year’s figures by 4.1 percent. Exports to industrialized nations increased in the first eleven months of last year by 3.6 percent compared to the previous year rising to 99.1 billion Euros. Exports to emerging nations grew by 4.8 percent to 52.2 billion euros in the same period. Exports to the euro-zone went up by 3.4 percent to 46.4 billion euros from January to November of last year compared to the preceding year. Deliveries to the United States grew by 3.8 percent to 12.5 billion euros in the same period; exports to China rose sharply by 15.6 percent to 13.6 billion euros. For the three month period September to November 2014, total exports were 6.9 percent higher than the previous year. The positive export trend should continue in the first quarter of 2015. At the start of the year export expectations of businesses in the sector for the coming three months are at their highest level since June 2014.

Mechanical Engineering: Diverging Trends

From September to November 2014, German machinery exports rose by a nominal 3.6 percent on the same period last year, although the markets displayed very different trends. Exports to the two largest markets experienced two-figure growth rates – this had not been achieved for a long time: exports to China were up by 11.8 percent; exports to the United States increased by 11.2 percent. There were, however, large differences within the EU. While exports to the EU as a whole increased by 6.2 percent, exports to the euro-zone countries only rose by 3.4 percent. Outside the euro-zone, the United Kingdom notched up a plus of 12.8 percent, as did Poland, the Czech Republic and Hungary with growth rates around the 20 percent mark. Within the euro-zone, exports to Italy grew by 14.4 percent, while they decreased to France and Austria by around 1.5 percent. Exports to Russia fell by 14.1 percent and to Turkey by 7.4 percent. There were also big differences overseas: while Southeast Asia saw an 11.4 percent increase, South-America slipped back by 21.4 percent. Exports to India grew for the first time at 3.8 percent. Orders from abroad have experienced a moderate increase. Consequently, first quarter 2015 exports could again slightly exceed the previous year’s level. This increase will not suffice, however, to generate dynamic export growth.
Non-ferrous Metals Industry more Confident at the Outset of the Year

After an unexpectedly robust performance last year, the German non-ferrous metals industry is looking to 2015 with much more confidence than it still was in December. Overall, German companies involved in metal production and metal processing achieved around 44 percent of their turnover in foreign markets. 58 percent of exports went to euro-zone countries – i.e. four percentage points less than 2013. Although exported tonnage rose slightly, the overall sector’s turnover abroad fell by two percentage points in comparison to 2013 to 19.6 billion euros due to fluctuations in the price of metal. Over the same period, aluminum industry exports showed a four percent increase rising to 7.0 billion euros. The non-ferrous metals industry (copper, zinc, lead, tin and nickel) shipped goods abroad worth 7.3 billion euros – three percent less than 2013. Exports from non-ferrous metal foundries dropped in the same period by two percent to 1.7 billion euros. Metal prices on the stock markets are also going in divergent directions: the prices of copper, – and to a lesser degree lead and tin, had a negative impact on 2014 foreign turn over compared to the previous year. Zinc, nickel and to a certain extent aluminum, however, experienced an upwards trajectory. Demand from the United States also developed in dynamic fashion. For 2015, the non-ferrous metals industry is anticipating tonnage sales abroad to show a stable to slightly positive trend.

Paper Industry: Sales Abroad in 2014 Continued at a Constant Pace

Foreign sales for the German pulp and paper industry showed a relatively constant trend in 2014 compared to the previous year (-0.1 percent). Sales in Western European countries rose slightly compared to last year (0.6 percent). On the other hand, sales in Eastern Europe and other key regions took a downwards turn in 2014 (-1.2 percent). Business abroad developed differently in 2014 depending on the product range. As such, foreign sales in paper, cardboard and paperboard for packaging increased by 1.8 percent and specialist papers for technical applications by 3.9 percent. As for graphic grade papers, the negative trend continued in 2014 with a 2.9 percent reduction.
Ceramics Industry: Export Growth Expected in 2015

2014 ended on a positive note according to figures available for the last quarter. The fine ceramics industry managed to increase its foreign sales by five percent compared to the previous year. Significant contributions towards this positive trend came from technical ceramics and porcelain producers. As a result of sluggish economic performance in Europe, the most important export destination for the fine ceramics industry, is not expected to be as strong in 2015 but nevertheless positive with growth of 1.5 percent. Precondition is that geopolitical unrest does not lead to further volatility on the markets. By way of contrast, a positive effect could come from an acceleration of growth in the U.S. economy.

Sector Focus: The Textile Industry

Textiles are innovative

Medium-sized businesses very much characterize the German textile and fashion industry and account for around 30 billion euros in annual sales (approximately 60 percent of which is textiles and 40 percent clothing). Overall, textile exports amount to around 24 billion euros. Textile companies produce a wide variety of primary and end products intended for a highly diverse range of uses. German fashion companies export attractive brands throughout the world. But nowadays there is a lot more to textiles: Textile materials are finding their way into many areas of use such as aircraft and automobile construction, the building industry or medical technology, which used to be reserved for conventional materials. The enormous advances in weight-saving and load-bearing capacity make fiber composites indispensable in air and space technology. Similarly, one cannot imagine the areas health and medicine without textiles. Textiles also have a major role to play in the fields of geo- and construction technology, energy and environment as well as living and life-style. Smart textiles will soon become a part of everyday life.

The German textiles and fashion industry is the world-leader in technical textiles. With approximately 1,200 companies and 120,000 employees in the domestic market, it is the second largest industry for consumer goods in Germany. Textile companies are important suppliers to sectors such as the automotive, air and space transportation, medicine, and geo-technology industries among others. Processes which require high capital investment and are technologically demanding are usually carried out at a German or European location, whereas work requiring high labor costs is primarily done abroad. The industry is also dependent on importing many industrial, primary products. The businesses involved are therefore important links in global, highly fragmented value chains.

Russia, Switzerland, the United States, and China, are amongst the most important markets and trading partners for the German textiles and clothing industry. Taking the United States alone, the trade surplus amounted to approximately 200 million euros in 2013. That is why trade liberalization is so important to this sector which is so geared towards exports and international supply routes. New free trade agreements, lifting tariff and non-tariff barriers to trade, and fostering trade facilitation are all important prerequisites to competing successfully in the international markets. It is for this reason that the General Federation of the German Textiles and Fashion Industry is also emphatically committed to the TTIP.
The German textile and fashion industry is highly geared towards exports. Borders which are open to investment and goods are of major significance to the success of our businesses. It is for this reason that the General Federation of the German Textiles and Fashion Industry is so emphatically committed to the signing of free trade agreements such as the TTIP.«

Ingeborg Neumann
Managing Partner of Peppermint Holding Ltd and President of the General Federation of the German Textiles and Fashion Industry

The General Federation of the German Textiles and Fashion Industry, which goes under the acronym t+m, is the umbrella organization for the German textiles and fashion industry and represents the sector’s interests in policy areas concerning economics, social issues, pay and education. Membership consists of 10 state-level associations and 14 trade associations. t+m is a member of the Federation of German Industries (BDI) and the Confederation of German Employers’ Associations (BDA). On the European level it represents the sector’s interests in the European association EURATEX. The representational role of t+m was further enhanced in 2015 when it was joined by the Federation of Footwear and Leather Goods Industries whose members turnover around 3 billion euros (of which more than 600 million euros in exports). t+m supports its members in opening up new markets by providing country analyses, networking facilities, and participation in trade fairs.

In addition, joint offices with its members in Moscow and Shanghai provide assistance to companies with sales and procurement projects.

With the purpose of attracting specialist staff t+m is also running the campaign Go Textile, which is an important mechanism in the recruitment and retention of the next generation.

www.textil-mode.de

Gesamtverband textil+mode

Ingeborg Neumann
In autumn 2013, the Federation of German Industries (BDI) formally commissioned IW Consult (IW Köln Consult GmbH) to conduct the study «Global Shift in Power – How is German Industry Faring in the Globalized World». In the study, global economic changes were illustrated in detail at both the macro-economic and company level. To this end, the study drew on indicators such as the share of global GDP, share of world trade and share of industrial production among others. In addition to comparisons with Germany’s main competitors, the study concentrated on the question of whether the increasing commitment amongst German businesses to locating production sites abroad was having the effect of consolidating or possibly undermining Germany as a business location. Based on more recent data from the OECD, the study also made it possible to look beyond the traditional concept of gross trade in goods and instead interpret trade flows in terms of units of valued added, i.e. in terms of the proportions of imports in exports.

The study clearly demonstrates that Germany is one of globalization’s winners; however, German success cannot be taken for granted. In the most recent «Global Competitiveness Report», which the Wold Economic Forum published in September 2014, Germany slipped from 4th to 5th place. Unless the right groundwork is laid now, the German economy will find it significantly more difficult to keep up with international competition in the future.

**The Industrialized Nations’ Share of Global GDP is Shrinking**

Change is part and parcel of the world economy. A megatrend that has occurred in recent decades is the global shift in power, which has given rise to new competitors and new markets. In 1995, approximately 94 percent of global economic power was generated by a group of 50 countries (G50) (World Bank database/own calculations IW Consult). Among these are 26 established, industrialized nations, such as Germany, the United States, Japan, and France, as well as 24 emerging, industrializing nations, including China, Brazil, India, and some Central and Eastern European countries. Whereas in 1995 the established, industrialized nations together accounted for 86.5 percent of the G50’s GDP, this share diminished to 69.6 percent by 2012. As far as manufacturing is concerned the catching-up process is even more noticeable than in the general economy. The new competitors from the developing and emerging countries were able to increase their share in the G50’s industrial value added from 16.2 percent to 41.3 percent.
German Industry – Winner of Globalization

Although global power has shifted considerably over the last 20 years, the established, industrialized nations were able to benefit from the catching-up process despite a reduction in their own market shares. This is due to the dynamic development of markets in developing and emerging countries. Above all, Germany has benefited from globalization, not least because of its broad range of industries. German products are in high demand in the emerging, industrializing countries. Another reason why Germany wins from globalization are the strong international ties of the local industry, particularly the intraregional links within the European production network, as well as the deep integration into international value chains.

Agnes Millack
Another facet of the global shift in power is the production side. While global exports of final goods rose by 138 percent from 2000 to 2011, trade in intermediate goods increased by 182 percent (World Input-Output Database (WIOD)). In this case, the established, industrialized competitors are the main drivers of the changes in global value chains. In these countries the imported intermediate inputs’ share of total intermediates grew from 20 to 27 percent, while the share of the emerging, industrializing nations remained at about 15 percent. The direct investment stocks in the emerging, industrializing countries also recorded a strong increase. However, most of the invested funds continued to come from established, industrialized nations.

**Current relationship between production abroad and domestic production**
Nature of production abroad relative to domestic production (in percent)

![Pie chart showing the relationship between production abroad and domestic production.](image)

**Motivation for Producing Abroad**

Businesses largely go abroad for two reasons: To produce more cost-efficiently and to access dynamically growing markets. However, expanding production abroad does not lead to an immediate decrease in domestic production. For a third of companies production abroad replaces domestic production – with an upward trend. This has two effects on the domestic market. Firstly, domestic investment is far more often directed at maintenance or modernization than expansion or upgrading. Secondly, any raise in manpower levels will mainly occur in foreign sites in the coming years.

**The Impact of Production Abroad on Germany**

To date little is known about the impact of production abroad on Germany as an economic location. Compared with other countries Germany has a lot of strengths, but costs are its primary weakness. Due to its strong focus on technology the German industry gained temporary advantages over its competitors again and again. These advantages serve to offset the relatively high costs in Germany. However, there is no reason for complacency, as German industry is coming increasingly under pressure. According to data obtained in the IW Future Panel, a representative survey conducted in autumn 2013 by the IW Cologne Research Institute of 1,900 businesses in industry or industry-related services, two thirds of the companies assume that their Chinese competitors will catch up considerably in terms of technological capabilities in the next five years.
Overall, domestic locations are generally not benefiting as much as locations abroad from the increased demand for German industrial products. Industry is not disappearing from Germany, but it is not growing at the rate it would have done in the past given the developments in sales potential in the emerging, industrializing nations.

The Importance of Location Quality

Location quality plays a particularly important role when it comes to strengthening domestic production. Companies have to regain their (temporary) advantages in international competition continually. Germany scores in terms of the necessary R & D infrastructure, yet there is still room for further improvement. To achieve this, tax incentives for research without red tape are required which facilitate companies to ensure for their temporary competitive advantages again and again. As Germany has a clear competitive disadvantage when comparing costs internationally, any new cost-intensive regulations and distribution policies are to be omitted. Finally, companies require planning certainty to continue investing in Germany.

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Arguments against producing abroad

Proportion of companies already abroad or for whom it is conceivable, in percent

Overall, domestic locations are generally not benefiting as much as locations abroad from the increased demand for German industrial products. Industry is not disappearing from Germany, but it is not growing at the rate it would have done in the past given the developments in sales potential in the emerging, industrializing nations.

If German companies are to remain competitive in future, three things need to be assured: The value chain, open markets and last but not least the location quality.

Securing open markets – facilitating trade, including imports

Multilateral and bilateral trade agreements are an important building block for Germany and Europe on the way to strengthening their position in the network of global value chains. Removing customs duties and regulatory barriers helps to reduce the costs of doing business, both in exports and imports, while also encouraging fair competition in global trade.

The most important approach to liberalizing and regulating free trade is still the World Trade Organization (WTO). To that end, the focus ought to be on a speedy conclusion of the ongoing Doha Round. In the short term, the agreement to simplify customs processes, known as the Trade Facilitation Agreement, needs to be put into force under the WTO, which will in turn restore faith in the WTO’s ability to act. To counter protectionist tendencies the WTO must carry out its central task of monitoring its members’ trade policy and mediating in disputes effectively. The WTO offers the long-term prospect of making the complex regulations in bi- and plurilateral agreements truly multilateral.
Furthermore, modern trade agreements with select partners (Free Trade Agreements) can contribute to strengthening the competitiveness of German companies. In addition to removing customs and tariff duties, these agreements contain chapters on technical and regulatory aspects, government procurement, and competition. As such, they supplement the multilateral process in a multitude of ways. Accordingly, the trade agreement with Canada (Comprehensive Economic and Trade Agreement (CETA)) ought to be ratified swiftly. Besides negotiations with the United States on a Transatlantic Trade and Investment Partnership (TTIP), there ought to also be serious commitment to step-up negotiations with the ASEAN countries and Japan as well as India and Mercosur.

Protecting German investments abroad

The volume of German direct foreign investment, which according to the Bundesbank has increased five-fold since 1990 to around 1.2 trillion euros (2012), is a direct expression of how globally interlinked the German economy is. According to the Bundesbank, German companies are generating a turnover abroad worth over 2.4 trillion euros (2012), more than double the value than that of German exports (2012: 1.1 trillion euros). When investing, German industry follows OECD guidelines for multinational companies and in doing so fosters ecological and social standards abroad. This makes comprehensive protection for investment even more important. Such protection is provided by 129 international investment agreements (IIAs) which Germany has concluded with other countries. As of 2009, concluding new IIAs and investment chapters in trade agreements has been the competency of the European Union. Any future European international investment agreements, e.g. like that within TTIP, should also guarantee sufficient protection for German foreign direct investment.

IIAs, however, are in clear need of reform and the ability of sovereign governments to pass laws for the common good must not be constrained. Concepts central to law, for example «indirect expropriation», have to be formulated more precisely. Arbitration proceedings ought to be more transparent and there should be a way to appeal. A modern IIA with the United States would constitute an important step towards a better standard for investment treaties as TTIP will be held up as an example. Furthermore, a new international standard could pave the way towards a multilateral framework for regulating and protecting investments, similar to that of the WTO on trade. Not least, TTIP’s chapter on investment will have an impact on current negotiations with China.

Increasing the tools at our disposal for business abroad

Besides securing Germany’s position as an attractive business location – above all addressing the high costs due to energy prices and regulation – concise strategies should be developed or strengthened to support companies in their international activities. There is already a multitude of mechanisms and instruments both on the federal and state level to support German business, such as the Federal Program of Trade Fairs Abroad (Auslandsmesseprogramm des Bundes, AMP) or the Program for Accessing New Markets of the Federal Ministry for Economic Affairs and Energy aimed at SMEs. These programs need to be afforded a more generous capital base without this leading to cuts in other areas of funding for economic development abroad.

Export credit guarantees are the single largest budget item in this regard. Given the growing diversification of markets, the scope of Hermes guarantees needs to be extended. As opposed to traditional markets in the industrial nations, markets in developing and emerging countries are characterized by greater risk. Given the increasing importance of global value chains, rules on local content for coverage should be more flexible. «Global sourcing» ensures that German exporters can maintain their international competitiveness, since it enables them to make use of comparative cost advantages. To that end, IW Cologne has delivered clear evidence that despite the higher proportion of foreign value added in German exports, the total value added – based on the effects of volume and export numbers – has increased. Therefore, foreign content of over 49 percent should be no reason to refuse Hermes insurance coverage to German exports.
The international value chain is exposed to numerous risks resulting from the interwoven nature of its multitude of subsectors. This applies equally to securing and extracting raw materials as it does to production, processing and transportation routes. From a security policy perspective, trade and logistics routes prove to be particularly vulnerable: raw materials and goods are transported via water, air, rail, road and pipeline. Additionally, a large part of the logistics today is now organised digitally, allowing cyberspace to become an all-encompassing area covering value added and trade networks.

Security risks

Current security risks are extremely heterogeneous and increase exponentially when crossing states which are politically, socially or economically fragile. They range from various types of crime such as maritime piracy, smuggling, theft, blackmail, corruption, espionage, sabotage, and manipulation of critical infrastructure to politically motivated violence and natural catastrophes.

The effects of the risks are extremely varied in nature. In the worst case they lead to delay or even break-down in the value chain. As such, each of the individual links in the chain sees itself exposed to different risks. However, they cannot be viewed in isolation because the risks too are often linked to one another whether via land, air, sea, or cyberspace.

Lack of risk management

For this reason comprehensive risk management is required which addresses the risks that can affect the entire trade and logistics network. Despite all the trends towards globalization and networking, there has been a clear lack of commitment to this on the economic, political and research front to date. Admittedly, there are various rules and forms of voluntary self-regulation in the EU in particular, but these mainly concern individual logistics branches or are one-sided in focus. More than anything there is a lack of coherent harmonization. Even in companies with global reach there are seldom adequate strategies for risk-managing the value chain. There are three decisive reasons for this:

Firstly, the risks are underestimated both in terms of probability and effect. The reason for this is that the security of the trade and logistics chain is a ‘wicked Problem’: a wicked problem is generally defined as one with infinite, often interdependent causes, of which each is unique in nature. There can therefore be no general test for potential solutions, just as there can be no single right answer. Added to this with regard to the value chain is the fact that many of its risks are founded on general political conditions: criminality and political violence flourish primarily in fragile states, and natural catastrophes have a far greater impact within those as well. This quickly seduces security managers and senior management staff into sitting on their hands as the perception is that there is very little ability to influence events. Consequently they prefer not to get involved at all in these types of risks – or rather, not until their own house is on fire.

Secondly, it is a difficult undertaking to try to justify the expense of risk prevention. The reason being, to put it simply: nobody is willing to offer up praise or funds to solve a problem which has not yet appeared.

Thirdly, establishing comprehensive risk management strategies all too often falls due to the considerable need to exchange ideas and cooperate on the basis of trust. For one, the intense competition generated in the globalised economy makes it more difficult to build up trust and share information. Moreover, the actors involved not only have their own very specific sets of interests, but also very different forms of cooperation and communication particular to their company or branch’s identity.

Possible courses of action

Preventing and averting security risks is first and foremost a sovereign function of state, even if it is a question of the vulnerability of economic processes. However, politics cannot fulfill the task alone. On the one hand, there are budget constraints which already exist and which multiply when even more expenditure is called for in the security sector as a result of increased economic investment in regions with fragile state structures. On the other hand, one-sided political engagement to secure the value chain simply makes no sense: firstly, numerous state directives affecting the security of businesses will have to be implemented directly by the latter or with their cooperation; the result is a cat and mouse game of enforced cooperation. Secondly, the political machinery requires input from experts who gained it from practical experience before it can pass new directives affecting the value chain. This is because only those with first-hand experience know where the neuralgic points are and what can be done to get rid of them without negatively impacting processes which are running smoothly.
To meet these demands, the very first thing that needs to be done within individual companies is to create an awareness of potential security problems and that is from the very bottom to the very top. That means: companies need to conduct comprehensive, predictive risk analysis with the purpose not only of making their own house secure but also of finding out how they can contribute towards solving the overall puzzle of securing the value chain. To achieve this, they need to identify and evaluate system-critical points within individual production and logistics processes which are important to them and then filter out their respective dependencies on each other. Building on this, they can then focus on the most important risks and set about the process of extrapolating the appropriate operational and tactical measures to take. At the very latest at this juncture, it would be advisable to be looking around for suitable partners to cooperate with. It is highly probable that there are other actors, whether closely or remotely related to the specific branch in question, which are exposed to very similar risks and are also searching for solutions. If these actors come together to share their experience and knowledge and, additionally, draw on experts and representatives from other areas such as politics or civil society, they can then develop plans for avoiding security risks based on a common approach which is both more efficient and more effective.

In light of current developments on the political and security front and the degree to which international trade and logistics networks are ever more closely entwined, the establishment of an appropriate discourse and cooperative initiatives which build on that, are the first, long overdue, steps on the way towards securing international value chains.

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Guest contribution by Alexandros Ragoussis and Przemyslaw Kowalski (OECD)
»Developing Nations´ Participation in Global Value Chains«

Participation in GVCs in Africa and Asia is already widespread and is associated with positive outcomes, such as enhanced productivity, sophistication, and diversification of exports.

Low tariffs, engagement in regional trade agreements, open direct investment regimes, decent transport and logistical infrastructure, high standards of intellectual property protection, and high quality institutions are important determinants of participation in GVCs.

The proliferation of global value chains (GVCs) is a defining feature of 21st century economy. Driven to a large extent by multinational enterprises seeking efficiency, but also supported by technological changes and trade policy reforms, the »GVC Revolution« has brought about increasing specialization at the task and business function level that reaches both large and smaller firms. GVCs have deepened the process of globalization geographically by connecting more countries and markets: sectorally by intertwining primary resources, manufacturing and services activities; and functionally by integrating not only production and distribution but also R&D and innovation.

GVCs offer new opportunities to benefit from trade and investment

While some believe that there is nothing qualitatively new about international value chains, the emergence of GVCs does change our thinking about the effects of trade and investment.

For example, export competitiveness in the GVC realm is fundamentally linked with access to competitively priced imported inputs as well as access to efficient services. Border costs, such as import tariffs or inefficient customs procedures, get amplified when production processes involve multiple border crossings. International rules and standards take on heightened importance, while foreign direct investment — often thought of as a substitute for trade — becomes a key driver of exchange and competitiveness in international markets. Participation in GVCs does, however, also entail risks such as transmission through value chains of macroeconomic and natural shocks that require adjustments in firms’ monitoring and mitigation strategies.

One of the key implications of the GVC expansion is that it exposed the importance of access to imported intermediate goods and services inputs. Even relatively recently, economic development policies in many emerging and developing countries focused strongly on import substitution, i.e. replacing foreign imports with domestic production in order to reduce foreign dependency in order to support development of the domestic economies. Some countries are reconsidering these options in the context of slow and jobless post-crisis growth. In a world of complex products produced within GVCs, however, building a complete domestic value chain is often neither optimal nor even possible. Instead, governments can provide an enabling environment for domestic firms to join existing global value chains, most likely a quicker and less costly road to economic development.
New empirical evidence gathered and presented in the forthcoming OECD report provides a starting point for policy makers in African and Asian regions to assess their countries’ GVC engagement and to consider policy options. It shows that participation in GVCs in these regions is already widespread. It also provides evidence that engaging more widely in GVCs, whether by using more foreign value added embodied in imported intermediates or importing more sophisticated intermediates, is associated with positive outcomes. These include enhanced productivity, sophistication and diversification of exports, even if there is a large heterogeneity across income groups (OECD, 2015).

Policies can play significant role in facilitating GVC participation

In broad terms, there is, as yet, little sign of a «factory Africa» emerging along the lines of «factory Asia» where regional trade in intermediates is a dominant feature. With some exceptions, African countries draw on foreign inputs to a much lesser extent than their peers in Asia. Exports of processed intermediate products by African countries are generally much less diversified in terms of numbers of products traded and markets served. Survival rates of intermediate trade in Africa can be as low as half those observed in Asia.

The study finds that structural characteristics of countries, which are not easily influenced by policies in short- to medium-term, appear to prevail as determinants of GVC participation. Firms in countries with larger domestic markets, for example, can draw on a larger array of domestic intermediates both in terms of purchases and sales. Developed countries tend to source more from abroad and sell a higher share of their gross exports as intermediate products. The structure of production and geography also matters a lot: a broad manufacturing base and proximity to large ‘headquarter’ economies tend to increase supply and demand for foreign intermediates. Yet, trade and investment policies, such as low tariffs, engagement in regional trade agreements, open direct investment regimes, decent transport and logistical infrastructure, high standards of intellectual property protection and high quality institutions are also important determinants of participation in GVCs.

National factors influencing the proportion of foreign value added in gross exports
(Percentage of gross exports)

Which markets does Robert Bosch Ltd operate in and where do you expect future markets to be?

«As a leading international company in the field of technology and services with a turnover of 48.9 billion euros, the Bosch group operates across the globe. However, our core markets are in Europe, North and South America and Asia. With the following corporate divisions, Mobility Solutions, Industrial Technology, Consumer Goods plus Energy and Building Technology, we currently operate in around 50 countries. If you include our distributors we are represented in around 150 countries. As such, with our products we basically have a presence all over the world.

As for growth, we are currently seeing our business activity in Asia and North America develop positively. China is particularly prominent, but India and the ASEAN countries are also important pillars for us in the region. In my opinion this will remain the case for a while. On top of that, we are currently increasing our activity in Africa, as we see enormous growth potential there which can be further increased.«

How does your company integrate into global value chains and what effects do free trade agreements or, for that matter, different rules of origin have?

«As a global company with a workforce of around 300,000 we are of course highly dependent on global value chains, for example in our capacity as a supplier to automobile manufacturers. In this regard, free trade agreements are an important element of our strategic planning in that we try to make the best use of low customs duties in our production processes. In the end, our product has to fulfill the rules of origin which our customer demands. For that reason, even when buying raw materials, we have to make sure that we do not fail to meet that objective in the end. That might appear labor-intensive at first sight, but in the end it ensures preferential access to important markets which we and our customers would like to serve successfully.«

How important is the German market to your company and what advantages do you see in the openness of the German economy?

«The German market and the European single market continue to be of great importance to our company. In 2014, we still achieved around 26 billion euros in turnover in Europe alone,
Our Recipe for Success: See Change as an Opportunity

»Made in Germany« is a global brand. Our products are in demand internationally, German companies are perfectly placed on the global stage with their quality and skill in engineering. So Germany has a solid foundation. Really? Is it not the case, to keep things in focus, that the first cracks are perceptible? Isn’t stagnation looming in the long-term, or even decline and weakness? Isn’t too much self-satisfaction and staidness shining through as the statisticians’ number columns and upwards trends are proudly presented?

I don’t think much of alarmism and painting a black picture, but rather reassurance and realism. The pressing questions are evident: is Germany now living off the fat of the land? Are we wallowing in our ancestors’ inheritance? Is there a lack of will to change? Do we see the signs of the times in a rapidly changing world? Can we find contemporary answers today to yesterday’s challenges? Do we almost consider welfare and prosperity as a God-given right? The question is how Germany remains competitive in the long term.

Firstly: Our attitude to acting independently has to change.

Germany must turn into the land of milk and honey for those who act with entrepreneurial spirit or simply want to make more of themselves. It needs its children taught from early years to look critically at the givens, to question common approaches to life and work, curiosity for the very different solution. That is how progress comes about. Independent thought and action are indispensable for successful entrepreneurship and professional advancement. Whoever risks something new for themselves and wishes to take on others, must have the red carpet rolled out for them. Whoever fails in an entrepreneurial undertaking once, must get a second chance. We need respect and un-bureaucratic support in financial institutions and public administrations instead of mistrust and ignorance. The back burner needs to be removed from the office, the sluggish office mole fed its last supper.

Bosch Markets and Facts 2013

<table>
<thead>
<tr>
<th>Region</th>
<th>Total Turnover (in millions)</th>
<th>Employees</th>
<th>Manufacturing Sites</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bosch Group Total</td>
<td>46.1 b</td>
<td>281,000</td>
<td>220</td>
</tr>
<tr>
<td>Europe</td>
<td>55% of turnover</td>
<td>174,000</td>
<td>140</td>
</tr>
<tr>
<td>America</td>
<td>21% of turnover</td>
<td>34,000</td>
<td>33</td>
</tr>
<tr>
<td>Asia Pacific</td>
<td>24% of turnover</td>
<td>73,000</td>
<td>52</td>
</tr>
</tbody>
</table>

Source: Robert Bosch Group Ltd.
Secondly: Make it possible to combine work and family.

The lament about the lack of skilled workers is omnipresent. But if you examine the situation of women in our society, you can only shake your head. Women and men who are single parents or parents bringing up children and people caring for family members with all their concerns belong at the very heart of our efforts. Adequate provision of child care, flexible working patterns, flexible funding for curricula, home help, fair pay, individualized qualification and career plans are not «nice to have» but an absolute must. This is a pressing mammoth task for the whole of society not just for those in politics.

Thirdly: See digital society as an opportunity.

It is mainly medium-sized businesses rather than large corporations which perceive risks associated with digitalization. They have hardly any interest in «industry 4.0», avoid expensive investments, are concerned about their data security and the unusual demands on their workforce. The digital revolution which is currently taking place affects our economic, political, and social life. It should not worry us, but rather it offers us unimaginable opportunities. In sync with the transformation in the energy industry, new products and new forms of cooperation are coming into being: the world is edging closer together. Installation of information super highways has to be accelerated vigorously; the tsunami of data and information, the digitalization of products and processes need highly qualified, specialized staff; IT specialists have just as much to come from Europe as the IT programs themselves.

Fourthly: From the land of guest workers to a society embracing immigration.

Migration to Germany is as old as Germany itself. Yet, foreigners still frighten a lot of people; the doors are shut. If we want to attract specialists from other parts of the globe and ensure they are moved into jobs smoothly, we have to offer them and their dependents a culture that is welcoming. It is not enough to forever see ourselves as a country that takes in migrants. The task now at hand is much more one of moving towards a society which embraces immigration. What is needed is openness of the whole of society so that foreigners are welcomed with open arms. The aim of a modern immigration policy is to invite people to stay permanently for the long-term with a dual bonus: one for the immigrant and one for our country.

Fifthly: Innovation as a prerequisite for competitiveness.

As a schoolboy, I looked at the map of the world hanging up at the front of the classroom: Europe in the middle, Asia as an appendix at the right edge. In future, we should use maps with China or the United States in the middle, in order to see the risk Germany runs of being an outsider put in palpable form before our very eyes. If we do not wish to be marginalized in the concert of world events, we need to have a change-around in our heads. Constant upgrades to products and processes, the synching of research to the economy, of innovation to investment are all guarantors of long-term competitiveness particularly for small and medium-sized businesses. The only raw material we have is located between our ears and we need to make the best possible use of it.

Germany has to constantly fight to regain its position at the head of the pack. Here, the recipe for success is openness and the ability of our economy to constantly transform itself. As the Chinese proverb goes: «When the wind of change blows, some build walls and some build windmills.»

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A Year of Modi in India: The First Signs of Reform Are Visible

After the Bharatiya Janata Party’s (BJP) landslide victory in the parliamentary elections in May 2014, Narendra Modi was sworn in as India’s new Prime Minister. In October he was able to strengthen his position when the BJP won important regional elections. In these elections the BJP primarily expressed support for economic reforms.

Even if it did not come to the »Big Bang« reforms investors expected, important groundwork for reform can be seen: increases in public sector efficiency, a rise in investment in infrastructure projects, liberalization of important sectors plus the first reforms in labor law. Alongside this, with his project »Make in India« Modi wants to strengthen India as a place to locate production in the face of global competition. At the Hanover Trade Fair, where India is this year’s »key partner Country«, Modi will present this in Germany.

Hopes of Modi revitalizing the economy are reflected in current growth prognoses. The IMF, for example, has revised its prognoses upwards and now assesses that India could grow faster than China in 2017. Whether the reforms are actually implemented depends first of all on the ability of the government to focus on objectives. The position the Upper House takes on the announced reforms will also be paramount, however. Here, the BJP’s coalition alliance is clearly in the minority. Whether it will come to any compromises between the Upper and Lower House should soon be revealed when a new uniform value added tax, which is an important building block in Modi’s reform program, is introduced.

Another issue, which the German economy will judge Modi by, are the negotiations on a free trade agreement between the EU and India. Amongst others, the EU expects clear concessions from India where access to public procurement is concerned. The procurement market is still difficult for foreign firms to access. Modi has not yet set out his position on this.

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TTIP: German industry demands cross-industry rules of origin

The Transatlantic Trade and Investment Partnership (TTIP) aims to promote growth and jobs on both sides of the Atlantic. In order to provide improved market access through preferential tariffs, TTIP’s preferential rules of origin ought to be simplified. This is especially important considering the large bureaucracy involved in the implementation of the rules and the high costs associated with compliance. Given these costs, it becomes less and less attractive to make use of preferential tariffs. According to various studies (including a recent study by the World Bank) complying with rules of origin in their current form does not pay off for companies when the margin between the MFN tariff (the bound most favorite nation tariff at the WTO) and the preferential tariff is only two to six percent of the value of a good.

This dilemma is particularly clear in the case of the transatlantic market: About two thirds of the U.S. and the EU MFN tariffs for industrial goods are already low with only zero to five percent of the good’s value. As such, the profit margin between the preferential tariff and the MFN tariff is quickly eroded if the costs of rules of origin are too high. Regardless of their size, all companies are affected by the relatively high compliance costs. However, for small and medium-sized enterprises they are a particular burden. Reducing administrative costs in trade, for example by simplifying rules of origin, would allow many of them to trade across the Atlantic for the first time.

The BDI therefore calls for a uniform cross-industry value added rule of 50 percent in TTIP, under which an economic operator can freely choose between the European and U.S. calculation methods with the exception of agricultural products, whereas agricultural products are considered being those of chapters 1-24 of the Combined Nomenclature.

As an alternative to the cross-industry value added rule, the criterion of »change in tariff heading/subheading« should also be applicable if required. As a further alternative, selected product specific processing rules would be applicable for certain products. Their definition would be sector-specific. Overall, BDI advocates a five-column model, which is described in more detail on the BDI homepage.

>> To the position paper
### BDI proposal for cross-sectoral rules of origin

<table>
<thead>
<tr>
<th>HB-Position</th>
<th>If necessary, description of the product</th>
<th>Uniform cross-industry value added rule</th>
<th>Sector-specific change in tariff heading/article heading</th>
<th>Sector-/product-specific processing rules</th>
</tr>
</thead>
<tbody>
<tr>
<td>123456</td>
<td></td>
<td>EU: ≤ 60% non-originating material US: ≤ 40% net cost</td>
<td>For certain industries</td>
<td>Sector specific</td>
</tr>
</tbody>
</table>

Source: BDI

If a cross-industry value added rule was established in the TTIP, this would not just reduce the transaction costs in transatlantic trade. It would also counter the trend towards ever more complex trade rules which overlap and partially contradict each other.

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Current Developments in Russia

Waiting for a cease-fire in the Russia-Ukraine conflict

After tough negotiations, Russia and the Ukraine agreed to a cease-fire for the crisis-hit region of Donbass as well as a peace process in the Minsk Agreement on 12 February 2015. However, the cease-fire which has been in place since the 15th February is fragile. The EU is maintaining its sanctions against Russia. The last of a series of 13 rounds of sanctions to date came into force on February 16th: An additional 19 people including the Deputy Minister of Defense and 9 separatist groups were added to the sanctions list. If the agreements made in Minsk are kept, the sanctions could be loosened step by step – if not, the EU is threatening a further increase in sanctions.

The EU backs diplomacy and sanctions

In the United States, pressure to supply the Ukraine with weapons to defend itself has grown recently. Europe appeared skeptical; Chancellor Merkel and President Hollande stressed that they continue to back negotiations. In addition, political pressure should be maintained on Russia by means of existing sanctions.

More precise sanction terms are a relief for industry

While German industry supports the Federal Government’s course of action, it is suffering significantly from the effects of sanctions. This is not due only to the fact that certain goods and technology can no longer be exported to Russia. Moreover, countries such as China, South Korea, Brazil, and India, which are not implementing the sanctions (e.g.), are trying to backfill the demand. Furthermore, it appears that the reputation of Germany is diminishing significantly in Russia according to surveys. Legal uncertainties and imprecise text passages in the terms of the sanctions are also putting the resilience of the export industry to the test. Since their initial release, the political front has reacted to these uncertainties and made important technical corrections in the form of the amendment decree (EU) 1290/2014 on 5th December 2014.

Such corrections are desirable. It would be even better if such legal uncertainties were avoided from the very outset when issuing regulations on sanctions. The European Commission is currently in the process of producing corresponding guidelines for interpreting EU sanctions regulations. To ensure these lead to better legislation, practical experience from industry ought to be taken into consideration.

Current German-Russian trade figures

Overall, trade with Russia diminished by 18 percent, e.g. six billion euros, in the period November 2013 to November 2014. Imports from Russia dropped in the same period by almost four percent. Particularly hard-hit were mechanical engineering and construction as well as trade in automobiles and agricultural equipment. As a result of Russia’s counter-sanctions, exports in fruit, meat and milk products also dropped. Within the EU, Ger-

![German exports to Russia in Bn Euro](chart.png)

Looking ahead

The framework agreement hammered out in Minsk concerning the monitoring of the peace plan also spells out trilateral negotiations on implementing Ukraine’s EU association agreement with EU and Russian participation. The «vision of a humanitarian and economic area from the Atlantic to the Pacific» was also reinforced. German industry now hopes that concrete actions will follow these accords and that talks will ensue ranging from deeper economic cooperation to a common free trade zone.

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EU Parliament Discusses a Regulation on the Handling of Raw Materials from Conflict Regions

The EU Commission’s draft regulation from March 2014 on the handling of raw materials from conflict or high-risk regions continues to take shape in Brussels. The Commission’s proposal envisions a voluntary system of self-certification for responsible recipients of minerals and metals from conflict regions. The area of application in the current draft is restricted to following raw materials: tin, tantalum, tungsten and gold. The Commission’s aim is to sever the connection between trade in raw materials and the financing of armed groups, such as in the Democratic Republic of Congo.

In a draft report by the Parliament’s trade committee, which is to be submitted for ratification in March 2015, there is support for large parts of the Commission’s proposal and for retaining its voluntary basis. The Parliament’s committees for development and for foreign affairs respectively take a different view, each having submitted their positions on the Commission’s proposal.

Both not only express their support for binding regulations on trade in conflict minerals. They are also pushing to subject end producers to the regulation.

In the BDI’s opinion, it is not possible to trace back minerals along the entire length of the supply chain. In the worst case, the regulation could lead to a general avoidance of conflict regions. Moreover, to curtail conflicts, work with the respective regions needs to be intensified, trade in raw materials in conflict regions needs to be monitored, and foremost, new measures need to be brought into sync with voluntary industry initiatives for responsible mining and trade in raw materials.

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China Lifts Export Quotas for Rare Earths as well as for Tungsten and Molybdenum

After the Chinese government reduced export quotas for rare earths, as well as tungsten and molybdenum as of 2010, it announced that the export quotas for these raw materials were to be abolished in 2015. In doing so, China is complying with the WTO’s March 2014 dispute panel finding. The WTO panel declared in favor of the complaint lodged on behalf of the United States, the EU, and Japan that this practice was distorting competition. In the first instance China appealed against the judgment, however, it was confirmed again in August 2014 by the WTO appellate body. The WTO found that Chinese export tariffs and quotas for rare earths could not be justified on the basis of environmental protection or sustainability if domestic exploitation was not simultaneously subjected to the same restrictions.

Nevertheless, the end of export quotas does not mean an end to all the measures which distort trade and competition in the export of rare earths. China is replacing export quotas with a system of export licenses and in doing so retains control over exports of rare earths. In addition, more than 90 percent of the global market supply is currently extracted in China where six (state) firms still dominate the market. According to the Federal Institute for Geosciences and Natural Resources (Bundesanstalt für Geowissenschaften und Rohstoffe, BGR), demand for rare earths has in fact diminished as of late due to successful efforts to find substitutes as well as the growing trend of converting from LCD to LED technology. At the same time, the BGR is warning against premature euphoria – given China’s monopoly position, German industry should continue to make efforts to diversify its supply of raw materials in order to prevent possible shortcomings in the future.

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Stable Growth in Sub-Saharan Africa

According to the World Bank, there was a slight increase in economic growth in Sub-Saharan Africa in 2014 compared with 2013 despite regional crises. Average growth increased from 4.2 percent in 2013 to 4.5 percent in 2014. Investment in the areas of infrastructure and telecommunications in particular, as well as the expansion of the financial services sectors were key factors for stable economic growth in countries like Tanzania, Nigeria, and Uganda. African currencies too, barring a few exceptions, were able to stabilize.

The International Monetary Fund’s (IMF) Regional Economic Outlook published at the end of 2014 predicted economic growth for 2015 of 5.75 percent. For low income countries in particular, such as the Ivory Coast, Chad, and the Democratic Republic of Congo, economic growth of eight percent is expected.

Due to the decline in the price of oil, however, the IMF had to revise its prognosis to 4.9 percent in January 2015. Next to South Africa and Angola, Nigeria, as the largest oil producer on the continent, is particularly affected by the decline in the price of oil. The IMF is now expecting 4.8 percent growth for Nigeria as opposed to the 7.3 percent predicted at the end of 2014. As the most populous country with the largest economy south of the Sahara, ahead of that of South Africa, Nigeria’s economic performance has a direct effect on the expected economic growth for the whole continent.

Both the IMF and the World Bank are optimistic that the continent will continue to become more attractive as a result of investment primarily in infrastructure, agriculture, and expansion of the service sector. The integration into global value chains in particular is a prerequisite for sustainable growth.

Sub-Saharan Africa therefore remains an interesting growth market for German firms. BDI welcomes that the German government has extended its guarantee instruments for business transactions between German exporting companies and countries of the Sub-Saharan region. From now on, deliveries of goods and services to public customers in Ethiopia, Ghana, Mozambique, Nigeria and Tanzania can be covered under export credit guarantees (Hermes insurance). This was a much needed step into the right direction.

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Vietnam: FTA Negotiations in the Final Stretch

Negotiations on a free trade agreement (FTA) between the European Union and Vietnam could be concluded as early as the first half of 2015. The last round of negotiations took place in early March (9th-13th) and could arguably be the last full round of negotiations.

In recent years Germany has had a growing trade deficit with this South-East-Asian country (see figure below). In order for Germany to better benefit from the transformation in Vietnam, the following points have to be addressed in the FTA:

- With the exception of used cars, used textiles, industrial waste and salt, Vietnam is offering to remove all import tariffs on industrial products. However, to improve access to the market, Vietnam ought to agree to considerably shorter timelines for removing import tariffs on industrial products. To date, the intention remains to have long transition timeframes of ten years for motor vehicles and seven to ten for machines and chemical products. The BDI takes a critical view of the fact that Vietnam wishes to retain the possibility of customs duty drawbacks. In addition, Vietnam has not yet expressed its willingness to dispense with export tariffs.

- Due to Vietnam’s high (and partially illegal) sugar imports from Thailand and the unfair competition this generates, the German sugar industry has spoken against opening the EU market for sugar or products with a high sugar content.

- The BDI is also pursuing considerable improvements in obtaining access to the public procurement market in Vietnam. The government bodies included in Vietnam’s procurement offer do not suffice. Besides the central level, it contains e.g. Hanoi City, Ho Chi Minh City and parts of the civilian procurement for the Ministry of Defense as well as a few additional services. There is still room for improvement, for example the inclusion of construction work for Ministry of Transport tenders plus regional and local (sub-central) level units, service providers, and state firms. The threshold at which the rules for awarding contracts come into play is particularly unsatisfactory. For central government bodies this is 15 times higher than the standard in the Government Procurement Agreement of the WTO.

- Another important aspect for German industry is protecting investment through the FTA. Unfortunately, we expect the level of investment protection to stay well behind that of the current BIT between Germany and Vietnam.

In order to reduce or avoid non-tariff trade obstacles, the negotiations partners should agree to mechanisms to facilitate information exchange and consultation. For example, specific regulatory accords have been identified for the pharmaceuticals sector, however, for the automobile sector they still do not go far enough.

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China Plans to Increase Access to Government Procurement Markets – but Will it Be Enough?

At the end of December 2014, China presented a 5th improved offer to the WTO for participation in the Government Procurement Agreement (GPA). There is, however, no doubt that the GPA members will demand more far-reaching concessions.

As to when and whether China will actually present a new GPA proposal remains to be seen. The GPA liberalizes access to government procurement between its members. For BDI, extending the GPA to more countries is a key issue, as government procurement on average makes up 10 to 15 percent of a Country’s GDP. Furthermore, in many industrialized and emerging nations outside of the EU this market remains very much closed off. Currently, 15 parties are signed on to the GPA, which encompass 43 WTO members (including the United States, Japan, and the EU with its 28 member states). In its 2001 protocol of accession to the WTO China committed to signing on to the GPA.

Although China’s latest offer of accession is still considered confidential, it was published in the press in January. Improvements on the previous offer consist of the inclusion of 15 rather than ten of the 22 provincial governments. The thresholds which determine when GPA obligations come into force were broadly brought down to the standard levels of the other member states. The offer includes more services and other important areas of construction such as road and engineering as well as storage and industrial facilities. Transition deadlines were also reduced.

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Total volume of Chinese public procurement

Ulrich Grillo, BDI President and B7 Host, at the B20 Coalition Meeting in Istanbul

At the second B20C Plenary Meeting from January 18th to 19th in Istanbul, BDI President Ulrich Grillo met the B20C Chairman and CEO of the Canadian Chambers of Commerce, Perrin Beatty, and Haluk Dincer, President of the Turkish Association of Industry (TÜSIAD) and host of the Turkish 2015 B20 presidency.

The purpose of the meeting was to agree on the focal points for next year and to strengthen the exchange between members.

In 2015, Turkey took over the G20 presidency from Australia and in November will host the upcoming G20 summit of the heads of state and government. In addition to establishing the G20 business forum (B20) in 2012, the «B20 Coalition» (B20C) was established. Whereas the B20 receives businesses and organizations with an international focus such as the BIAC, ICC or the IOC on an informal, rotating basis, the B20C is a permanent alliance of national trade and industry associations. The B20C serves to foster ongoing exchange and is characterized by being very strongly established in national politics.

In the framework of the B7 summit, the next meeting will take place in Berlin in spring of 2015. In June 2014 Germany took over the presidency of the G7 and will host the next summit of heads of state and government on the 7th and 8th June 2015 at Schloss Elmau (Bavaria). The BDI has taken on the task of organizing the 2015 B7 summit. To that end, the BDI has invited the trade and industry associations of the G7 to Berlin on the 19th and 20th of May 2015.

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Having examined the Chinese offer, the BDI believes that significant improvements are imperative. China should include all provinces, service providers, and state companies in the GPA. The same applies to the autonomous regions and local levels of government which so far have been completely omitted. In addition, construction services should be captured as comprehensively as possible. There is also room for improvement in the remaining services. In the current draft these are too narrowly defined, resulting in the exclusion of a large percentage of services considered usual in the standard GPA package. In the services section in general and in construction in particular, the thresholds needs lowering to GPA standard levels, or even to the lower EU levels. It is also of note that the revised document still contains broad exception clauses in its general terms, for example «to protect important political objectives» or to take account of local production or technology transfer in the conditions of tender. From a German industry perspective these are unacceptable in this form.

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The BDI Foreign Economic Report provides information on a quarterly basis on current trends in foreign economic affairs. The spotlight is on developments in the global economy and Germany’s foreign trade. Germany is the runner-up in world exports, with exports accounting for about half of the German GDP. One quarter of jobs in Germany is dependent on foreign trade. Global economic interdependence continues to be one of Germany’s major economic strategies for success.

The BDI Foreign Economic Report has been appearing since the year 2000 and is distributed every quarter to nearly 3000 readers from the fields of politics, administration, business and science. The English version is also distributed to an international readership. We present on a regular basis the results of BDI sector surveys on export prospects for German industry.

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### Upcoming BDI Foreign Trade Dates

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