Economic Insight

Location quality: Germany is now only EU average

Nothing is more dangerous than complacency. Germany is beginning to see this too. Our analysis of the World Bank’s Doing Business report shows that Germany has slipped from the top ranks to the midfield of EU countries. Eastern European countries have ambitiously implemented reforms and overtaken Germany.

Germany drops back in international location competition

Since the financial crisis, the attraction of Germany as a business location has deteriorated significantly compared to other EU countries. This is the message from our analysis of the Doing Business report recently published by the World Bank, which assesses the location quality of a country from the viewpoint of small and medium-sized enterprises. For each of the 46 World Bank indicators we have determined how much Germany deviates from the results of the best EU country. We have standardised and averaged these deviations.¹ This value gives the total distance to a hypothetical top location in the EU.

The good news is that the distance between Germany and a hypothetical top location has remained largely constant since 2012 after Germany edged further away from the hypothetical top location between 2009 and 2012 (chart 1). The bad news is, Germany has slipped from rank 12 to 14 in the EU rankings (chart 2). Germany has in fact not moved further away from the top location but has been overtaken by other countries that have pushed Germany into a lower position.

Germany was not idle …

Germany has not been inactive though. In the past few years, it has become much easier to start a business. While it took 17½ days to found an enterprise in 2009, it only required 10½ days in 2016. At the same time, the costs of setting up a company have more than halved from 5% of per capita income (2%). Moreover, the paid-in minimum capital has dropped from 41% of per capita income to 33%. In addition to starting a business, it has also become less expensive to provide it with electricity. A power supply connection for a company now costs 41% of per capita income, some 10% less than in 2009. Also, if an existing business becomes insolvent, creditors can expect 84% of their capital to be redeemed during the insolvency procedure, as against only 80% in 2009.

¹ The DB Index consists of ten partial indicators, quantified by 71 sub-indicators. We firstly calculate the difference between the level (w) of each sub-indicator for each country from the best sub-indicator level across all countries (min). We normalise the result (w – min) by dividing it by the difference between the worst level (max) and min: (w – min)/(max – min). We then average the standardised differences of the country across all sub-indicators of a partial indicator and then across all partial indicators.

Sources: World Bank, Commerzbank Research

For important disclosure information please see pages 5 and 6.
... but has also suffered setbacks

At the same time, though, other conditions for doing business have grown less favourable. SMEs now need 220 hours to complete their income tax returns, ten hours more than in 2012 and 20 hours longer than in 2009. Moreover, their tax burden has risen gradually from 44% of profits in 2009 to 49% in 2016. This puts Germany well above the EU average at 41%, and a long way from low-tax countries such as Ireland (26%) or top tax locations Croatia and Luxembourg (21%) (chart 3). It has become more expensive, too, to register property. It now costs almost 7% of per capita income to have real estated registered, as against 5% seven years ago. The increase is probably due largely to virtually all the German states having raised their property transfer tax at least once since the financial crisis in an attempt to make up for a budget shortfall.

Latvia, Lithuania and Slovenia are overtaking

At the same time, other countries, led by Latvia, Lithuania and Slovenia, have made great efforts over the past seven years and pushed through ambitious reforms, so that they now beat Germany in the location ranking (chart 2, p. 1). They have slimmed down their public sectors, making them more efficient, a move reflected impressively when starting a business. This procedure took 15 and 26 days respectively in Latvia and Lithuania in 2009, but it now takes 5½ days in both instances (chart 4). In Slovenia, businessmen can start operating within seven days, 1½ days less than in 2009. In addition, the minimum capital requirement, which in 2009 amounted to 14% of per capita income, was abolished in Latvia in 2011.

All three have long beaten Germany hands down as regards tax burdens. German business taxes have risen steadily over the last seven years, reaching the present 49% of profits, whereas in the other three countries they have fallen and now amount to only 31% in Slovenia, 36% in Latvia and 43% in Lithuania (chart 5, p.3).

Spain, Poland and the Czech Republic catching up

Latvia, Lithuania and Slovenia have now moved ahead of Germany. Spain, Poland and the Czech Republic, on the other hand, have managed to catch up (chart 2, p.1). In Spain and the Czech Republic it now takes 13 and 9 days respectively (2009: 61 and 17 days) to start a business (chart 4). Moreover, the Czech Republic dropped its minimum capital requirement in 2014, which had been about 30% of per capita income previously.

Moreover, these three countries have improved considerably when it comes to the registration of property. Polish administrations have reduced the time they need to register real estate from almost 200 days in 2009 to only 33 days (chart 6, p.3). In the Czech Republic, too, this administrative procedure has been shortened from 79 to 28 days. With 13 days, the Spanish authorities have always been relatively quick. The 52 days needed by the German authorities make German bureaucracy appear rather sluggish.

German competitiveness eroding at a broad front

The German economy has performed fairly well in recent years. The economy has quickly recovered from the crisis, unemployment has dropped and employment has reached new record levels every year. Inspired by this good performance, German politics have become complacent
and failed to make any major reform efforts in recent years. While the general conditions for small and medium-sized companies were improved in some areas, other countries implemented much more and more effective reforms. As a result, Spain, Poland and the Czech Republic have caught up with Germany as a business location, while other competitors such as Slovenia, Latvia and Lithuania have actually overtaken it. Our indicator thus puts Germany only in the midfield of EU countries (chart 7).

However, Germany’s weakening quality as a business location is only part of the puzzle as the competitiveness of the German economy is eroding on a broad front. For instance, the quick rise in unit labour costs – since 2008 they have been increasing at a similar pace to Italy ten years ago – has undermined the country’s price competitiveness relative to the other euro countries. At the same time, German companies’ profit margins have been under pressure for years as the sharp rise in unit labour costs coincides with only slow increases in sales prices, thus weighing on corporate investments. Another piece of the puzzle is the steady deterioration of transport infrastructure. For instance, price-adjusted transport infrastructure investments by the public sector have been on the decline for ten years, implying that the status quo has not even been maintained for years, with streets, bridges and waterways increasingly in decay.

Of course, all this is unlikely to result in an abrupt end to the sound German business cycle. After all, we are expecting the economy to grow by 1.8% this year. However, these structural deteriorations will probably mean that the German economy will be slow to work its way out of the next weak phase. To avoid such a situation, politics has to ensure that Germany does not get left behind.

**Chart 7: Locational quality: Germany only EU average**
Distance to a hypothetical top business location within the EU, in percent, 2016

**Sources:** World Bank, Commerzbank Research
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