Economic Insight

8 November 2016

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.

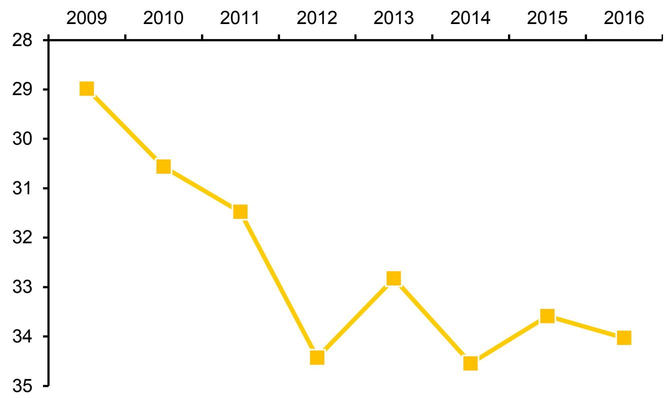
Germany was not idle …

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.

Author:
Dr Marco Wagner
+49 69 136 84335
marco.wagner@commerzbank.com

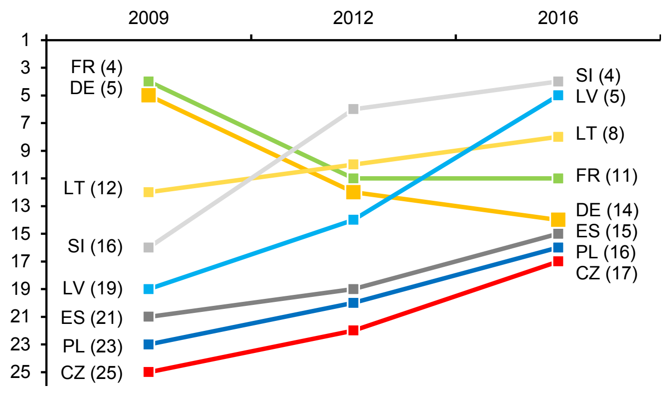
Chief Economist:
Dr Jörg Krämer
+49 69 136 23650
joerg.kraemer@commerzbank.com

CHART 1: **Germany upholds its distance from top location**
Germany's distance from a hypothetical top location within the EU, in per cent



Sources: World Bank, Commerzbank Research

CHART 2: **… but other countries are overtaking**
Country ranking by location quality within the EU; in brackets: rankings; location quality: distance from hypothetical top location within the EU



Sources: World Bank, Commerzbank Research

[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.

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

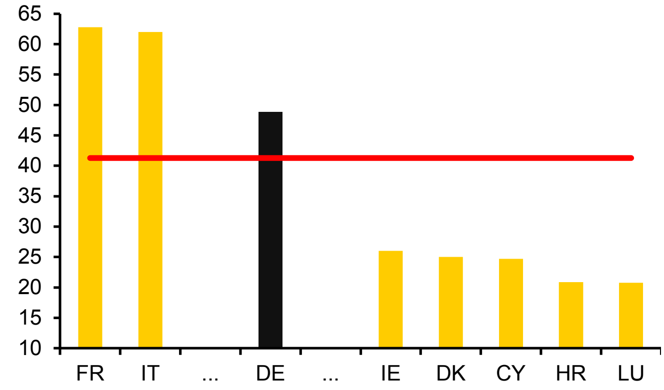
Latvia, Lithuania and Slovenia have now moved ahead of Germany. Spain, Poland and the Czech Republic, on the other hand, have managed to catch up (chart 2, p.1). In Spain and the Czech Republic it now takes 13 and 9 days respectively (2009: 61 and 17 days) to start a business (chart 4). Moreover, the 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

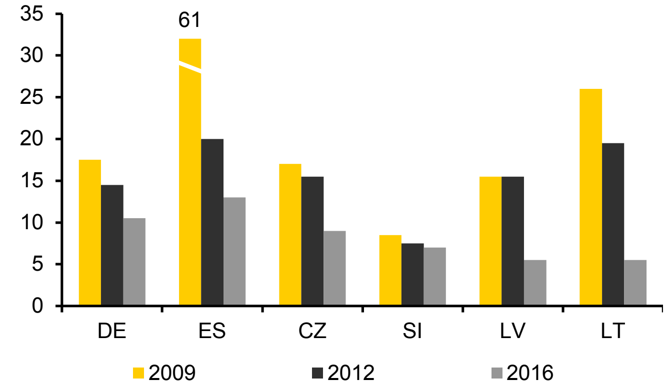
The German economy has performed fairly well in recent years. The economy has quickly recovered from the crisis, unemployment has dropped and employment has reached new record levels every year. Inspired by this good performance, German politics have become complacent

CHART 3: **Germany a high-tax country**
Corporate tax burden, in per cent of profits



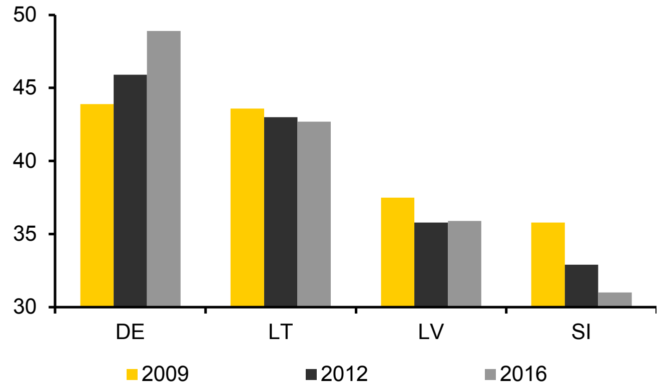
Sources: World Bank, Commerzbank Research

CHART 4: **Quick business formation in Latvia and Lithuania**
Time required to start a business, in days



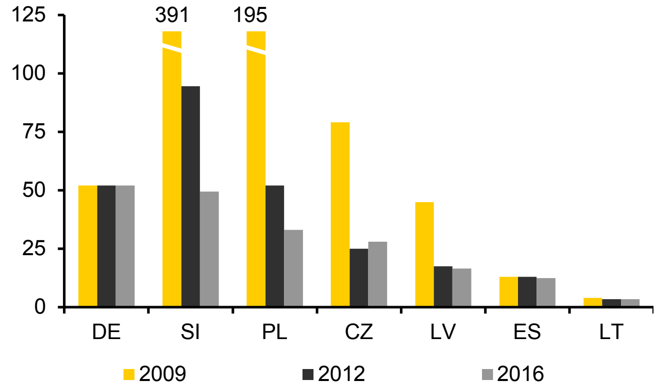
Sources: World Bank, Commerzbank Research

CHART 5: **Tax burden in Latvia, Lithuania and Slovenia is lower than in Germany**
Corporate tax burden, in per cent of profits



Sources: World Bank, Commerzbank Research

CHART 6: **Registration of property: German bureaucracy is sluggish**
Time required to register property, in days



Sources: World Bank, Commerzbank Research

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

In accordance with ESMA MAR requirements this report was completed 08/11/2016 08:03 CET and disseminated 08/11/2016 08:04 CET.
This document has been created and published by the Corporates & Markets division of Commerzbank AG, Frankfurt/Main or Commerzbank's branch offices mentioned in the document. Commerzbank Corporates & Markets is the investment banking division of Commerzbank, integrating research, debt, equities, interest rates and foreign exchange.

If this report includes an analysis of one or more equity securities, please note that the author(s) certify that (a) the views expressed in this report accurately reflect their personal views; and (b) no part of their compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or views expressed by them contained in this document. The research analyst(s) named on this report are not registered / qualified as research analysts with FINRA. Such research analyst(s) may not be associated persons of Commerz Markets LLC and therefore may not be subject to FINRA Rule 2241 restrictions on communications with a subject company, public appearances and trading securities held by a research analyst account.

It has not been determined in advance whether and in what intervals this document will be updated. Unless otherwise stated current prices refer to the most recent trading day's closing price or spread which may fluctuate.

Conflicts of interest

Disclosures of potential conflicts of interest relating to Commerzbank AG, its affiliates, subsidiaries (together "Commerzbank") and its relevant employees with respect to the issuers, financial instruments and/or securities forming the subject of this document valid as of the end of the month prior to publication of this document*:

Please refer to the following link for disclosures on companies included in compendium reports or disclosures on any company covered by Commerzbank analysts: http://research.commerzbank.com/web/commerzbank-research-portal/public-page/disclosures*

*Updating this information may take up to ten days after month end.

Disclaimer

This document is for information purposes only and does not take into account specific circumstances of any recipient. The information contained herein does not constitute the provision of investment advice. It is not intended to be and should not be construed as a recommendation, offer or solicitation to acquire, or dispose of, any of the financial instruments and/or securities mentioned in this document and will not form the basis or a part of any contract or commitment whatsoever. Investors should seek independent professional advice and draw their own conclusions regarding suitability of any transaction including the economic benefits, risks, legal, regulatory, credit, accounting and tax implications.

The information in this document is based on public data obtained from sources believed by Commerzbank to be reliable and in good faith, but no representations, guarantees or warranties are made by Commerzbank with regard to accuracy, completeness or suitability of the data. Commerzbank has not performed any independent review or due diligence of publicly available information regarding an unaffiliated reference asset or index. The opinions and estimates contained herein reflect the current judgement of the author(s) on the date of this document and are subject to change without notice. The opinions do not necessarily correspond to the opinions of Commerzbank. Commerzbank does not have an obligation to update, modify or amend this document or to otherwise notify a reader thereof in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate.

This communication may contain trading ideas where Commerzbank may trade in such financial instruments with customers or other counterparties. Any prices provided herein (other than those that are identified as being historical) are indicative only, and do not represent firm quotes as to either size or price. The past performance of financial instruments is not indicative of future results. No assurance can be given that any financial instrument or issuer described herein would yield favourable investment results. Any forecasts or price targets shown for companies and/or securities discussed in this document may not be achieved due to multiple risk factors including without limitation market volatility, sector volatility, corporate actions, the unavailability of complete and accurate information and/or the subsequent transpiration that underlying assumptions made by Commerzbank or by other sources relied upon in the document were inapposite.

Commerzbank and or its affiliates may act as a market maker in the instrument(s) and or its derivative that has been mentioned in our research reports. Employees of Commerzbank and or its affiliates may provide written or oral commentary, including trading strategies, to our clients and business units that may be contrary to the opinions conveyed in this research report. Commerzbank may perform or seek to perform investment banking services for issuers mentioned in research reports.

Neither Commerzbank nor any of its respective directors, officers or employees accepts any responsibility or liability whatsoever for any expense, loss or damages arising out of or in any way connected with the use of all or any part of this document.

Commerzbank may provide hyperlinks to websites of entities mentioned in this document, however the inclusion of a link does not imply that Commerzbank endorses, recommends or approves any material on the linked page or accessible from it. Commerzbank does not accept responsibility whatsoever for any such material, nor for any consequences of its use.

This document is for the use of the addressees only and may not be reproduced, redistributed or passed on to any other person or published, in whole or in part, for any purpose, without the prior, written consent of Commerzbank. The manner of distributing this document may be restricted by law or regulation in certain countries, including the United States. Persons into whose possession this document may come are required to inform themselves about and to observe such restrictions. By accepting this document, a recipient hereof agrees to be bound by the foregoing limitations.

Additional notes to readers in the following countries:

Germany: Commerzbank AG is registered in the Commercial Register at Amtsgericht Frankfurt under the number HRB 32000. Commerzbank AG is supervised by both the German regulator, Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), Graurheindorfer Strasse 108, 53117 Bonn, Marie-Curie-Strasse 24-28, 60439 Frankfurt am Main and the European Central Bank, Sonnemannstrasse 20, 60314 Frankfurt am Main, Germany.

United Kingdom: This document has been issued or approved for issue in the United Kingdom by Commerzbank AG London Branch. Commerzbank AG, London Branch is authorised by Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), and the European Central Bank and is subject to limited regulation by the Financial Conduct Authority and Prudential Regulation Authority. Details on the extent of our regulation by the Financial Conduct Authority and Prudential Regulation Authority are available from us on request. This document is directed exclusively to eligible counterparties and professional clients. It is not directed to retail clients. No persons other than an eligible counterparty or a professional client should read or rely on any information in this document. Commerzbank AG, London Branch does not deal for or advise or otherwise offer any investment services to retail clients.

United States: This document has been approved for distribution in the US under applicable US law by Commerz Markets LLC ('Commerz Markets'), a wholly owned subsidiary of Commerzbank AG and a US registered broker-dealer. Any securities transaction by US persons must be effected with Commerz Markets, and transaction in swaps with Commerzbank AG. Under applicable US law; information regarding clients of Commerz Markets may be distributed to other companies within the Commerzbank group. This research report is intended for distribution in the United States solely to "institutional investors" and "major U.S. institutional investors," as defined in Rule 15a-6 under the Securities Exchange Act of 1934. Commerz Markets is a member of FINRA and SIPC. Commerzbank AG is a provisionally registered swap dealer with the CFTC.

Canada: The information contained herein is not, and under no circumstances is to be construed as, a prospectus, an advertisement, a public offering, an offer to sell securities described herein, solicitation of an offer to buy securities described herein, in Canada or any province or territory thereof. Any offer or sale of the securities described herein in Canada will be made only under an exemption from the requirements to file a prospectus with the relevant Canadian securities regulators and only by a dealer properly registered under applicable securities laws or, alternatively, pursuant to an exemption from the dealer registration requirement in the relevant province or territory of Canada in which such offer or sale is made. Under no circumstances is the information contained herein to be construed as investment advice in any province or territory of Canada and is not tailored to the needs of the recipient. In Canada, the information contained herein is intended solely for distribution to Permitted Clients (as such term is defined in National Instrument 31-103) with whom Commerz Markets LLC deals pursuant to the international dealer exemption. To the extent that the information contained herein references securities of an issuer incorporated, formed or created under the laws of Canada or a province or territory of Canada, any trades in such securities may not be conducted through Commerz Markets LLC. No securities commission or similar regulatory authority in Canada has reviewed or in any way passed upon these materials, the information contained herein or the merits of the securities described herein and any representation to the contrary is an offence.

European Economic Area: Where this document has been produced by a legal entity outside of the EEA, the document has been re-issued by Commerzbank AG, London Branch for distribution into the EEA.

Singapore: This document is furnished in Singapore by Commerzbank AG, Singapore branch. It may only be received in Singapore by an institutional investor as defined in section 4A of the Securities and Futures Act, Chapter 289 of Singapore ("SFA") pursuant to section 274 of the SFA.

Hong Kong: This document is furnished in Hong Kong by Commerzbank AG, Hong Kong Branch, and may only be received in Hong Kong by 'professional investors' within the meaning of Schedule 1 of the Securities and Futures Ordinance (Cap.571) of Hong Kong and any rules made there under.

Japan: This research report and its distribution do not constitute and should not be construed as a "solicitation" under the Financial Instrument Exchange Act (FIEA). This document may be distributed in Japan solely to "professional investors" as defined in Section 2(31) of the FIEA and Section 23 of the Cabinet Ordinance Regarding Definition of Section 2 of the FIEA by Commerzbank AG, Tokyo Branch. Note, however, that Commerzbank AG, Tokyo Branch has not participated in its preparation. Not all financial or other instruments referred to in this document are available within Japan. Please contact the Corporates & Markets division of Commerzbank AG or Commerzbank AG, Tokyo Branch for inquiries on the availability of such instruments. [Commerzbank AG, Tokyo Branch] Registered Financial Institution: Director of Kanto Local Finance Bureau (Tokin) No. 641 / Member Association: Japanese Bankers Association.

Australia: Commerzbank AG does not hold an Australian financial services licence. This document is being distributed in Australia to wholesale customers pursuant to an Australian financial services licence exemption for Commerzbank AG under Class Order 04/1313. Commerzbank AG is regulated by Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) under the laws of Germany which differ from Australian laws.

Commerzbank Corporates & Markets

Frankfurt	**London**	**New York**	**Singapore**	**Hong Kong**
Commerzbank AG	Commerzbank AG	Commerz Markets LLC	Commerzbank AG	Commerzbank AG
DLZ - Gebäude 2, Händlerhaus	PO BOX 52715	225 Liberty Street, 32nd floor,	71, Robinson Road, #12-01	15th Floor, Lee Garden One
Mainzer Landstraße 153	30 Gresham Street	New York,	Singapore 068895	33 Hysan Avenue,
60327 Frankfurt	London, EC2P 2XY	NY 10281-1050		Causeway Bay
				Hong Kong
Tel: + 49 69 136 21200	Tel: + 44 207 623 8000	Tel: + 1 212 703 4000	Tel: +65 631 10000	Tel: +852 3988 0988