Why German business is desperate for a deal

*This recent report from the specialist German foreign policy portal **German-foreign-policy.com** provides valuable insight into the effect of Brexit on the German economy. If the EU and the UK do not successfully conclude a free trade agreement by the end of the year, the effect on the German economy will be dire. Nor has the predicted exodus of financial sector jobs from the City of London to Frankfurt materialised. The original report, which includes full references, can be viewed here.*

German business circles are vigorously pushing for a successful trade and partnership agreement with Great Britain. German businesses are already registering annual losses in the billions, because the EU has not yet agreed on regulations for its post-Brexit economic relations with the United Kingdom.

The German Institute for Economic Research (DIW) estimates a Brexit-induced slowdown in Germany's economic growth by 0.8% since the referendum in June 2016. Growth could fall by around 0.6% in 2021 alone if no agreement can be reached by the end of this year, according to the DIW. Current estimates predict this year's overall growth to be 0.7%.

Nevertheless, Brussels is pushing its luck by insisting that London make contractual adjustments to fit EU norms and standards – a step the British government, having gained independence through Brexit, strictly rejects. The German financial sector's gains through Brexit have turned out much smaller than had been hoped.

The EU’s Conditions

Brussels and London have now officially defined their positions for the negotiations on the trade and partnership agreement, aimed at regulating relations between Great Britain and the EU after the Brexit transition period ends at the end of this year. They pertain particularly to economic issues, but include also so-called internal security as well as foreign and military policy.

The EU Commission presented its draft negotiating mandate on February 3. In principle, it offers Great Britain free trade without tariffs and quotas – ultimately in the interest of German companies, such as BMW, which have production sites in the UK, and whose supply chains are closely linked to the continent. In return, the EU is demanding that London formally adopt EU norms, for example in social, environmental or climate standards as well as restrictions on state aid.

The EU Parliament formulated even tougher conditions, demanding, for example, compliance with EU product and consumer protection and EU VAT regulations. The Parliament is thus offering its support to Michel Barnier, the EU Commission’s Chief Negotiator, by serving as an instrument for increasing pressure on London. The EU-UK Coordination group of the EU Parliament, to which Barnier must report, is chaired by the German MP David McAllister (CDU).

“No EU Supervision”

On the other hand, Great Britain’s position was pointed out in part by Prime Minister Boris Johnson (in his speech Feb. 3), and more recently by British Chief Negotiator David Frost in Brussels. The United Kingdom is unwilling to formally accept EU standards. After the withdrawal no “EU supervision” will be accepted, Frost clarified. Johnson is seeking a free trade agreement along the lines of the one the EU has concluded with

Canada.

At the same time, according to Frost, London is prepared to reach agreements on a "level playing field" for example in questions of the environment and state aid, but nothing more. "How would you feel," Frost asked in Brussels, "if the UK demanded that, to protect ourselves, the EU must dynamically harmonise with our national laws set in Westminster and the decisions of our own regulators and courts?" If the EU is not prepared to agree to such an approach, Great Britain would seek trade relations comparable to those the EU has with Australia, Johnson declared already on February 3. The EU and Australia are currently trading under WTO rules, but are now seeking a free trade agreement.

Billions in Losses

The German business community in particular is warning against letting the negotiations fail. Due to the sharp drop in sterling's exchange rate and general uncertainty following the Brexit referendum results, German export enterprises have already experienced significant losses in trade with the UK. Exports to that country – which in 2015 were still running at more than €89 billion, ranking third among customers of German products – have fallen to less than €79 billion last year, while exports to the other EU countries increased. Today, the UK ranks fifth among Germany's customers.

According to calculations by the German Institute for Economic Research (DIW) in Berlin, the Brexit-induced slowdown in German economic growth means that, since 2016, growth has been around 0.8% less than what it would have been had the referendum not taken place. DIW President Marcel Fratzscher calculates that since Brexit, the costs to the German economy have been around €10 billion annually. With an eye on the Brexit-induced losses up to now, the DIW is pushing for an agreement with Britain by the end of the year. If this does not materialise, it would mean not only “lower domestic production and a loss of some exports to the United Kingdom,” but also a serious loss of exports to third countries. A Brexit without consensual agreement would sink German economic growth by 0.6 percent in 2021, predicts the DIW. That would have grave consequences: the German Chambers of Industry and Commerce (DIHK) are predicting this year’s economic growth to be only 0.7 percent.

Frankfurt’s wishful scenarios

Whereas Brexit has already significantly damaged the overall German economy, the hopes Germany’s financial sector had placed in it have hardly been fulfilled. Back in 2016–17, there had been predictions – spurred on by PR organizations in Hesse’s banking sector – that Brexit would lead to a massive migration of financial sector jobs to Frankfurt am Main. According to a study published in the summer of 2017, London would lose 10,000 finance sector jobs to Frankfurt. Since finance sector employees have generated a strong demand in other sectors in the Rhine-Main region, an additional 36,000 (‘cautious scenario’), perhaps even 88,000 (‘optimistic scenario’) jobs were expected to be created outside the financial sector. In Frankfurt alone, the additional annual tax receipts were predicted to range between €136 – €191 million. Other institutes, for example, the Landesbank Hessen-Thüringen (Helaba), were estimating an increase of around 8,000 jobs.

No Banking Boom

A current inventory paints a significantly different picture. A number of financial institutions have, in fact, opened offices in Frankfurt am Main, or increased their personnel – often because within the EU, financial transactions may only be made from locations within the EU. By late August 2019, 31 financial institutions had established new offices in Frankfurt for that reason, significantly more than in Paris (11), in Dublin and Luxemburg (each 9), or in Amsterdam (5).

However, this increase has, until now, been limited to an increase of only 1,500 financial sector jobs – merely one-sixth of the original prognosis. Frankfurt’s banking sector’s PR agencies still remain optimistic that, by the end of 2021, another 2,000 jobs will be added. At the same time, Helaba admits that these will hardly compensate for the current downsizing taking place in Germany’s major banks. According to these estimates, Frankfurt will have 64,500 jobs in the financial sector by the end of 2021, thanks to the aspired Brexit-induced increase – a mere 600 more than at the end of 2018, with subsequently a distinctly downward trend. This can be compared to approximately 380,000 finance-sector jobs in London. Therefore, while the economy as a whole is taking a beating, even Germany’s financial sector’s long-propagated ray of hope has proven to be a deception.