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Germany

Mittelstand Starved of Credit, Going Broke

by Lothar Komp

In Germany, the year 2002 began with a series of sensational mega-bankruptcies. First hit was Philipp Holzmann, one of Germany's oldest construction companies, with 23,000 employees. In March and April, one crash after another followed: The Thuringian construction service provider Mühl AG (3,800 employees); the second-largest German airplane producer Fairchild Dornier (3,600 employees); and Herlitz, the largest German maker of office supplies (3,000 employees). After a months-long tug-of-war between the bank supporters and the minority owners, Rupert Murdoch and Silvio Berlusconi, bankruptcy was finally declared by Kirch Media Corporation, with 6.5 billion euros in official debt and many more billions in optional liabilities—the largest corporate bankruptcy in the post-War German history. One must assume that we have not seen the last of the mega-bankruptcies for 2002.

Even as the big business bankruptcies monopolize the headlines, a process just as dramatic is taking place at the small and medium-sized business level. A mass sickness of these *Mittelstand* businesses has set in, which in its extent is unprecedented. And the crest of the bankruptcy wave has yet to be reached. By the figures posted by the Federal Office of Statistics, insolvent companies in 2001 rose to 32,300, some 14% more than the year before. Not only was a new bankruptcy record set, but the rate of growth in the number of bankruptcies doubled from the previous year.

Some 9,000 companies were liquidated last year alone, of which 3,700 were industrial firms. Since 1990, the number of insolvent companies has increased each year, with the exception of 1999.

More than half a million jobs were eliminated in the *Mittelstand* sector in 2001 alone, of which 330,000 were in the former West Germany, and 173,000 in former East Germany. The insolvent businesses had a debt volume of 31 billion euros, compared to only 24 billion euros the year before.

Among the 32,300 companies which went bankrupt in 2001, about 50 were businesses with more than 500 employees. The remaining, overwhelming majority, were small or belonged to *Mittelstand* entrepreneurs. Around 56% of the bankruptcies came from businesses with 5 employees or fewer. This year it will only get worse. The Creditform agency expects that the current trend of numbers of bankruptcies will increase dramatically, and the number in 2002 could even surpass 40,000.

New Bank Priorities

The avalanche of small- and medium-enterprise bankruptcies is driven, on the one hand, by the looting of global economic activity outside Germany. The strong export business of these industrial firms is being torn to shreds. The depression of the German construction sector, which started in the mid-1990s, is still deepening, not least because of the financial bankruptcy of the cities, and therewith the current implosion of public spending for infrastructure.

That gloomy situation shows us only part of problem. Just as significant is the radical change in the German bank sector, which has been taking place since the 1990s and is now affecting the German business sector with full force. The successful post-War model of the German credit system, with its strong General Welfare component and its long-term attachments of businesses to their respective local banks, has always been a sore spot for advocates of the Anglo-Saxon "share-holder" mentality, one that they have demanded should be crushed.

The lever for this action is the globalization of the financial markets and the worldwide merger-mania. Even for German banks, the saying now goes: Eat or be eaten. The only ones who can survive, are the ones who are big players in the profit game of "investment banking." From this viewpoint, the allocation of credit to business is nothing but a burdensome, barely bearable side game. Much more profit is made through mutual takeover of international corporations, as with stock swaps. Often business credit is only used as bait, to get credit-using companies to accelerate up through the stock market exchanges. The other businesses are told to go to *Sparkasse* (savings banks) and other partly or wholly subsidized creditors; or, if they are young and promise fairytale growth rates, they go to "venture capitalists."

Almost all large banks in Germany have tightened their criteria for *Mittelstand* loans over the last few years. Some have even openly stated that they want to completely dump their small business clientele. The German savings and loan association (DSGV) summed it up last Autumn as follows: "The private competition, including the Deutsche Bank, Dresdner Bank, Commerzbank, and HypoVereinsbank, are pulling out systematically from doing business with medium-sized companies."

The Advancing Storm: Basel II

It will only get worse. For a long time, governments, regulatory authorities, and banks have been trying to rewrite the Basel equity directives of 1988. By those rules, banks could only loan out 12.5 times the amount of equity the debtor company possessed. In other words, the equity of a company must be at least 8% of the volume of credit it carries, in order to be protect the bank from failure of the company.

Because the banks clamored against these regulations, the

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Unions Warn Germany On Maastricht Austerity

Don't cut the budget if you want to balance it, German Trade Union Federation (DGB) chief economist Heinz Putzhammer warned in a statement on Feb. 21. He explicitly rejected German Finance Minister Hans Eichel's "fixation" on a short-term balanced budget.

"An absolute fixation on a balanced budget by 2004 is too dangerous," Putzhammer said, because "sufficient growth is not guaranteed. But, what we know for sure, is, that if the state pulls the brakes to consolidate the budget in 2003, and especially in 2004, too strongly, the following will happen: Unemployment will grow, and not shrink. The scissor between reduced tax income and social security payments, and the higher costs of unemployment will open further, instead of closing. The new debt of the public will rise, and not shrink. . . ."

The DGB economist explicitly attacked the European Stability Pact (based on the Maastricht Treaty) as unworkable: "What we need, in Germany and in Europe, is a sustainable and economically sensible strategy of consolidation. The European Stability Pact is not the right example. On closer inspection, it has a number of deficiencies in regards to 'sustainability' and 'economic sensibility'. . . ."

Instead, "infrastructure investments have to be stabilized at a politically desired and economically sensible level. Consolidation will then be accomplished . . . on the income side, in an economic upswing. Public investments can be financed through credits, if public infrastructure expenditures serve, as in many cases, several generations."

On April 5, Putzhammer reiterated his comments, in a statement greeting "decisions of France, not to realize the ambitious austerity plans of the euro countries by 2004, at any cost. Finally, an important EU member is realizing and indicating, that, in all probability, it is impossible to reduce the new debt incurred to zero, by 2004. . . . If recognition prevails in France that the austerity aims can be only reached, if at all, by a highly risky therapy for Euroland, then the German Government should no longer resist becoming smarter."

Putzhammer's arguments fall far short of the real scale of the present crisis. But, they reflect a growing awareness that in order to overcome it, the logic of the Maastricht criteria has to be discarded. It is unusual for trade unions to issue such harsh criticism of a Social Democrat-led government in an election year, and is as indicative of the mood among workers, as the growing strike ferment in Germany.

Basel Committee for Bank regulation has been working for some years with representatives from central banks and bank regulators from the United States, Canada, Japan, and ten Western European nations, to reform these rules. The main point of discussion is that debtors will be differentiated by their creditworthiness, so that banks will be able to loan first-class debtors much more than 12.5 times their equity. The losers of the new system have already been determined: the *Mittelstand.*

One of the strongest principles of banks used to be the fact that the creditor banks, with years of service in the local area, were familiar with the owners of the credit-taking enterprises, such that they would be able to make a realistic estimation of their creditworthiness. But now, "objective" rating methods are being introduced, which decide whether and under what conditions credit will be given. The criteria include equity and "cash flow." The criteria will be summed up, and a rating determined, by a rating agency, from which every business will have to ensure that it gets a rating at a cost of about 50,000 euros ($45,000).

The large rating agencies, with whom the speculative excesses of technology shares revealed a complete incompetence and blindness, will thus become also the arbitrators over credits to the industrial *Mittelstand.* On account of the chronic weakness of company stock capital in the smaller and middle-sized enterprises in Germany—precisely because they traditionally do not want to become dependent on shareholder-value interests—it appears that bad ratings, and with it higher interest rates, are preprogrammed.

Certainly, the new directives, called "Basel II" and scheduled to take full effect in 2006, will serve the banks as a pretext to tighten the conditions for middle-sized enterprises.

The 3.3 million *Mittelstand* enterprises of Germany create 80% of all jobs, 85% of the apprenticeships, earn half of the Gross National Product, and form the basis for two-thirds of the public social income and domestic revenue. If they are sacrificed to the interests of the global finance markets, it is all but over for the German economy.

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