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Will economic relations between Germany and Poland thrive post-coronavirus?

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The economic relations between Germany and Poland have continued to develop with remarkable dynamic in the last decade, after already experiencing a rapid upturn with Poland's accession to the EU in 2004. The volume of trade has grown twelve-fold since 1994. Today's very lively economic exchange between Poland and Germany can rightly be described as an important anchor of stability in the relationship between the two countries. The asymmetry that still characterises German-Polish economic relations is diminishing. Poland is Germany's fifth most important supplier and its investment in Germany is increasingly gaining importance. As neither of the two countries is able to ward off the coronavirus-induced recession, the question now is what consequences the pandemic will have for bilateral trade and whether they can continue on the path of economic cooperation that has been so successful to date.

Poland's foreign trade – a fundamental structural change since 1990 with a strong shift to the west

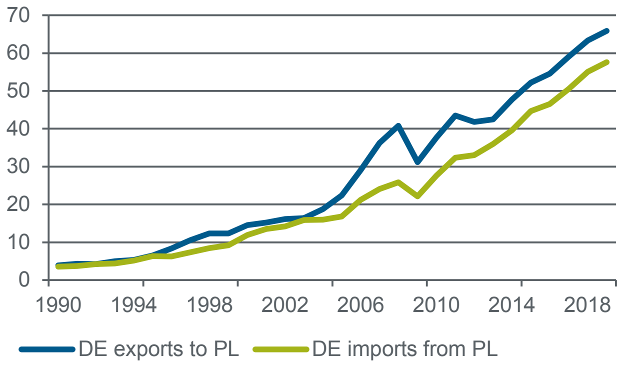
The political upheaval of 1989/1990 and Poland's resulting decision to transition to a market economy system initially spelled the end for the economic exchange between the Federal Republic of Germany and Poland under the rules of traditional East-West trade.[1] With the implementation of a comprehensive economic liberalisation (specifically including foreign trade) on the basis of the Balcerowicz Plan[2], the sector ministries that had full competence were dissolved and businesses on the Polish side were subsequently permitted to manage their foreign trade partners themselves without restriction as well. This resulted in a very far-reaching regional reorientation of foreign trade. The share of Polish foreign trade with developed Western economies grew fast from 1990, the more so as the loss of most of the Soviet/Russian market forced imperatively a swift diversification of sales markets. Poland's rapid economic orientation towards the west went hand-in-hand with a quickly growing foreign trade volume. The resulting need for modern technologies and consumer goods was largely met by neighbouring Germany – the world's third-largest economy at the time. Germany's steady sales market provided a very propitious environment for the development of aspiring Polish companies interested in planning certainty. At the same time, German enterprises benefited from the Polish sales market, which was very receptive after years of undersupply, from local industries' vacant production capacities and, not least, from labour cost advantages. This enabled the Federal Republic of Germany at the beginning of the 1990s to become Poland's most important trading partner by far.[3] The closer economic ties forged at the time were a determining factor in Germany's consistent support for Poland's integration into the West (particularly NATO and the EU).

German-Polish trade has grown continuously over many years

In the ranking of Germany's most important trading partners, its second-largest EU neighbour – which has been growing at above-average rates – has continuously climbed the ladder in the past years – from rank 12 prior to EU accession to rank 6 (as at 2019; behind China, the Netherlands, the US, France and Italy but ahead of the United Kingdom). The volume of trade between Germany and Poland has grown massively since 1990, increasing by 4.2% to EUR 123.5 billion in 2019 (see Figure 1 for the development of bilateral exports and imports), while Germany's foreign trade overall increased by a mere 1.0% in 2019.[4]

Figure 1: Trade between Germany and Poland

In EUR bn



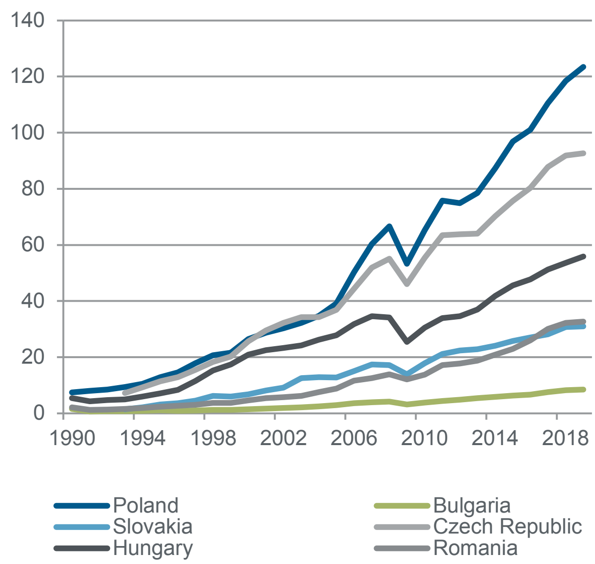
Source: German Federal Statistical Office

German-Polish trade has also shown impressive growth compared with other central European countries (cf. Figure 2). Owing to its proximity and gradually modernised economic structure, Germany's eastern neighbour has benefited greatly from the strength of the German economy in the past decade and the resulting demand for goods and services. Germany is far and away Poland's most important trading partner – for imports as well as exports.

By way of illustration, Germany accounted for 27.5% of Poland's goods exports in 2019 (followed at a considerable distance by the Czech Republic with 6.2% and the United Kingdom with 6.0%). It is also Poland's main supplier with a share of 21.4% (followed by China with 12.3% and Russia with 6.5%).[5] Poland's export structure, which has been gradually improved since 1990 and is now extremely well diversified (with no sector currently taking more than 12%)[6], is characterised by processed goods such as motor vehicles including accessories, mechanical engineering products and a significant amount of furniture and household appliances, as well as high-quality food products (Germany's imports from Poland were last dominated by motor vehicles and parts with 13.6%, machinery with 9.9% and food with a share of 9.3%).[7] Numerous foreign direct investment (FDI) transactions drive this modernisation and export growth and significant amounts of German investment in Poland since the beginning of the transition of 1989/1990 (cumulative inflows of EUR 35 billion up to 2018) have been flowing into high value-added manufacturing (especially the automotive industry) and the finance and insurance industry. Considerable sums have lately been going to the outsourcing of business processes (particularly in the IT sector) (cf. Figure 3).

Figure 2: Development of foreign trade volume between Germany and selected countries

In EUR bn

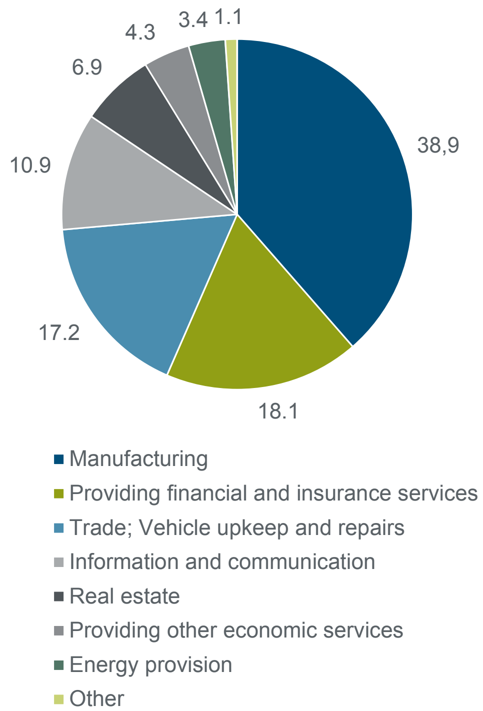


Source: German Federal Statistical Office

In the other direction as well, investment in Germany by Polish firms that have bolstered their capital base has increased noticeably. Polish direct investment in Germany grew vigorously of late,[8] filling a stock of EUR 2 billion according to Deutsche Bundesbank (2018). The approximately 1,500 Polish companies currently operating in Germany are mainly active in the construction, transport/logistics and food sectors. Many successful, well-funded Polish SMEs are aspiring to expand into international markets. Germany is a particularly attractive investment destination (cf. Figure 4).New business development is especially welcome and needed in the border regions of Brandenburg and Mecklenburg Western Pomerania, many of which are structurally weak, demographically disadvantaged and in search of new prospects. All of this also underscores the fact that the lopsided image of Poland as an 'extended workbench', which was justified to a certain extent in the 1990s, no longer reflects the reality. Since then, wages in Poland have risen continuously and the country has lost its importance as a location for mass industrial production of goods with a high proportion of manual work to countries such as Romania and Ukraine.

Figure 3: Target sectors of German investment in Poland

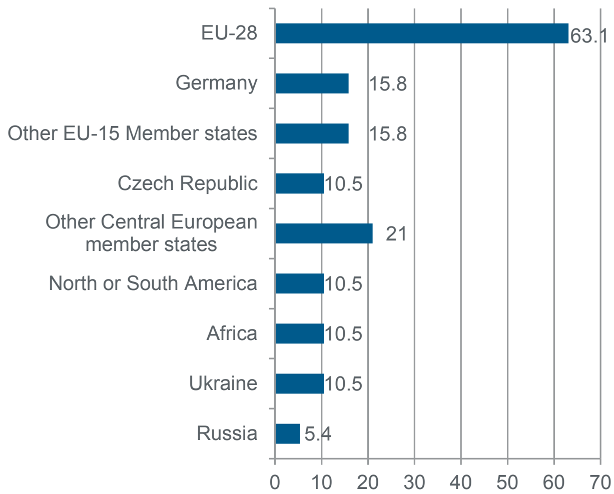
In per cent



Source: Polish-German Chamber of Industry and Commerce

Figure 4: Target regions of Polish foreign direct investment for 2020–2021

In per cent of internationally active companies



Source: Polski Instytut Ekonomiczny (PIE)

Poland – an attractive but changing market as a result of the coronavirus crisis

German businesses very quickly recognised Poland's potential as a country[9] with a domestic market of 38.5 million residents whose economy was opening up to the West and stabilising. For the now approximately 5,000 German businesses operating in the Polish market (as at 2020), the main investment motives – apart from the highly educated, motivated workforce and the tight network of qualified supplier firms – include attractive taxation rates (a 19% corporate tax rate, much lower than in Germany), competitive labour costs and generous support schemes available from EU funds, which along with the national support instrument of Special Economic Zones also benefited the considerable local investment activity of the German automotive industry, for example. For the many small and medium-sized enterprises (SMEs) operating in Poland, risks are also very much limited because of the country's geographic proximity. Businesses have welcomed the recent significant improvements to public infrastructure (motorways, ports, improved wastewater infrastructure, among others) – also thanks to EU structural assistance.[10] Legal enforcement is one of the issues which German businesses regard as problematic in Poland. A challenge that has even grown in the past years is the already complicated and frequently changing tax system. The amendment to the tax laws introduced in January 2019 recently brought numerous changes that pose high barriers for foreign investors in particular.

However, the progress which Poland has made in modernising its infrastructure and industry has led to a decrease in demand for capital goods. Private consumption has grown considerably in the past years but is expected to drop sharply, particularly in the luxury segment, mainly as a result of imminent dismissals due to the coronavirus crisis. The EU Commission has forecast a jump in unemployment rate from 3.3% in 2019 to 7.5% in the current year. The Bank Pekao expects a more prolonged downward movement than during the financial crisis of 2008/2009 because domestic demand is likely to settle on a lower level for the time being as a result of the COVID-19 pandemic. The cost pressure for businesses associated with recent strong wage increases, in turn, harbours the risk that more production will be shifted abroad – although Poland's unit labour costs have increased rather moderately in the past three years and at a slightly slower rate than in the peer countries of Slovakia, the Czech Republic and Hungary. However, there is more than a remote likelihood that the realignment and shortening of production chains after the COVID-19 pandemic has subsided will benefit the Central and Eastern European region as a whole. European businesses are debating intensively whether and how to go about such realignment. Demands from policymakers for more European sovereignty, e.g. European autonomy in key technologies, are also likely to support the scenario of a substantial shift of economic activities ('nearshoring') to Europe and act as a driver. These changing conditions and the enormous efforts required to stabilise the economic structures in the context of the coronavirus pandemic in particular should be enough reason for aligning economic policy strategies even more closely on both sides of the border. The planned EU reconstruction package will significantly benefit Poland and offer both countries the opportunity to introduce structural changes to their economies which will, importantly, take into consideration the experiences from the crisis. These additional funds would help Germany's second-largest neighbour, which has generally proven to be very capable of responding to the crisis, to push forward programmes already designed at national level that are aimed at improving the public health system, which is suffering from structural deficits, and the still extremely alarming air quality. A substantial portion of EUR 1.6 billion from the national crisis support package is also intended to bolster the healthcare system.

In the coming weeks it will be essential to take concerted action on restarting the economy. The lifting of restrictions on entry into the country and mandatory quarantine requirements for incoming travellers now decided by the Polish government will greatly simplify this difficult process.

What can be done to further strengthen German-Polish economic relations?

Poland and Germany can look back on many joint economic achievements and both economies are now closely interconnected. Today the two heavily export-oriented countries share a common interest in open markets, for example. Poland is expected to come out of the crisis with the smallest economic downturn of all EU countries, with the EU Commission forecasting a decline in GDP of 4.6% for 2020 and growth of 4.3% for 2021. This should positively influence the further development of close economic cooperation. At present, several high-end German investment projects in the advanced technology sector, such as an aircraft turbine monitoring joint venture in the south-eastern Polish city of Rzeszów, have particular importance and a signalling effect, as they align with the Polish plans for modernising the economy[11]. The economic cooperation that has grown strongly in a spirit of trust in the past 30 years is an important pillar particularly when the partnership is accompanied by diverging political viewpoints. The border regions, specifically the twin cities[12] where social and economic life is spreading across the border in the best European spirit, have been developing as beacons of a particularly fruitful cooperation over the past decades. That the economic exchange will also act as a driver in the future cannot be taken for granted. It will require even broader dialogue and specific action, particularly because of the greater challenges that can be expected in the coming years. For a start, the difficult questions associated with the coronavirus pandemic (in particular, commuters, harvest workers, movement of goods and services) will have to be re-addressed and solved in the most future-proof way possible. Supply chains are largely functioning again and service provision should now generally become possible again after the restrictions on travel to Poland have now been lifted. Projects that relied on assemblers ('assembly chains') have often suffered of late. With respect to public health regulations, in future a (better) solution would be for both sides to voluntarily adhere to the more stringent relevant national regulation in the economically and socially closely connected border regions – in order to maintain regional business cycles in the best way possible.[13]

The German side should also take into consideration that the presence of Polish medical and nursing staff has indeed proven to be 'systemically relevant', particularly for the federal states of Brandenburg, Mecklenburg Western Pomerania and Saxony, where a significant proportion of hospital staff come from Poland. In this regard it is surely appropriate to demonstrate solidarity with the Polish side, where physician density is much lower than in Germany, through the provision of funding and other resources. Conversely, German businesses would welcome greater willingness from the Polish executive to negotiate regulatory aspects, for example, which would also further strengthen investment propensity. In the light of most recent experience, the further intensification and even broader diversification of economic cooperation[14] being planned by Poland and Germany should be expanded to include the joint production – possibly as a whole-of-Europe approach – of 'systemically relevant' strategic products such as personal protective equipment, ventilators and specific medicines such as antibiotics and others. The restructuring of production chains that is to be expected after the coronavirus pandemic could make German-Polish cooperation gain further importance.

[1] Up to 1989, East-West trade was characterised by many barriers and restrictions. These were mostly due to the fact that business contacts were handled between state institutions (ministries) on the part of the state socialist countries and private-sector units (enterprises) on the western side. As a consequence, and also because of political restrictions, the volume of trade remained on a relatively low level. The Federal Republic of Germany's trade with all Comecon states combined was roughly equal to its trade with Austria.

[2] At the end of the year 1989, the Polish parliament initiated a comprehensive reform agenda that included transitioning the hitherto moderately reformed but no longer functioning centrally planned economy (inflation rate in 1989: 251%, source: OECD Economic Outlook December 1991, p. 75) into a market economy of Western type as quickly as possible ('shock therapy'). The key elements of this strategy were simultaneous deregulation and liberalisation of foreign trade, designed to confront Poland's companies quickly with world market conditions.

[3] The foreign trade structure was clearly based on that of pre-war times. In 1928 Germany accounted for 27% of Poland's imports (USA: 14%, Japan: 0%) whereas in 1989, owing to political conditions, it was only 12.9%. After 1990 that share reached the 20% mark again and it is now above 21%. Figures according to Helmut Kramer, Die Integration Osteuropas in die Weltwirtschaft (*Eastern Europe's integration into the world economy* – our title translation, in German only), WIFO, monthly reports 4/92 and GTAI (FN 7).

[4] Cf. https://www.destatis.de/DE/Themen/Wirtschaft/Aussenhandel/Tabellen/rangfolge-handelspartner.pdf?__blob=publicationFile.

[5] GTAI, Poland, Wirtschaftsdaten Kompakt (Compact Economic Data), May 2020, p. 3/4

[6] For more on the transformation of the structure of Polish exports cf. Marcin Piatkowski, Das Wunder an der Weichsel, Polen ist Europas am schnellsten wachsende Volkswirtschaft (*The Miracle on the Weichsel, Poland is Europe's fastest-growing economy* – our title translation, in German only) Friedrich-Ebert-Stiftung 2019, p 2f. For the current shares of the individual economic sectors in Poland's exports cf. GTAI (FN 5).

[7] GTAI, Poland, Wirtschaftsdaten Kompakt (Compact Economic Data), May 2020, p. 3/4

[8] dto., p. 5

[9] In the course of the 1990s, Poland increasingly gained control of the rampant inflation of the transition years of 1989/1990 through a restrictive monetary policy and from 2002 inflation has dropped to levels no longer unusual for the EU. Ever since Western creditors cancelled a very large portion of Poland's high debt from the communist era up to 1994, the country has pursued a measured expenditure and debt policy. Most recently (2019), aggregate public debt was just under 48% of GDP and thus lower than in Germany (59.8%).

[10] For details see the highly respected annual investment attractiveness ranking of the German Chambers of Commerce (AHKs) for Central and Eastern Europe (CEE), in which Poland ranked third of 15 CEE countries in 2019 (behind Estonia and the Czech Republic).

[11] The Polish Government has adopted the 'Strategy for responsible development' (Strategia na rzecz Odpowiedzialnego Rozwoju – SOR) in 2017 with the aim of significantly increasing incomes while promoting social, economic and regional cohesion. The five pillars of the strategy are re-industrialisation, innovation, the formation of savings and of a capital basis with development potential and the further strengthening of exports, social and regional development. Re-industrialisation is to take place by concentrating resources in selected sectors. Each region is to push forward a specific 'intelligent specialisation'. The government aspires to converge on average EU GDP by purchasing power parity by the year 2030 (according to Eurostat, Poland is currently at 73%).

[12] This refers to the 'twin cities' of Frankfurt (Oder) / Słubice, Guben/Gubin, and Görlitz in Saxony and Zgorzelec in Lower Silesia, which proclaimed themselves a European City already in 1998.

[13] Dr Lars Gutheil, Executive Board Member of the Polish-German Chamber of Industry and Commerce, telephone conversation on 17 April 2020.

[14] Cf.https://m.bpb.de/internationales/europa/polen/306778/dokumentation-das-entwicklungsministerium-der-republik-polen-das-polnisch-deutsche-wirtschaftsforum-eine-neue-qualitaet-der-zusammenarbeit