

GEO-POLITICS (2): THE GERMAN PARIAH

THE IMF claims that the global economy is on the verge of recovery. Beware. The "signs" which treasury spokesmen claim to observe in the heavens will take a long time to manifest themselves in new jobs and real increases in income. The unseemly way in which Germany has been turned into a pariah is a far more potent indicator.

Washington (federal deficit: \$400 billions) is telling Bonn to cut its deficit! London (where interest rates were raised to record levels, to crush the boom of the 1980s) is telling Bonn to ease its grip on rates on the Euro-money markets.

What this reveals is that the leading economies are rudderless, cruising downhill on a wing and a prayer. There is precious little that the investor can do in the short-term, except sit tight. But what about the medium term prospects? With inflation NOT about to rescue anyone, where should the money go? When it comes to the "fundamentals," the Germany economy - despite the current labour unrest (the most intense strike action in 18 years) - is the most reliable of them all.

Take equities. In EI's view, there is still a substantial shake-down of prices. During the '80s, prices in Japan, the USA and Britain rose much faster than in Germany; but they also plummeted faster. Fine, for risk-taking speculators; but for anyone seeking solid growth with a minimum of risk, Germany remains the best bet.

How do we account for this relative performance? Not in terms of the fundamentals, for Germany - along with Japan - outshone everyone.

Why, then, the difference in stock prices between Japan

and Germany? Answer: land speculation. In Japan, investors used equities as a proxy for direct dealing in the land market. They speculated in the shares of land-rich companies. In addition, Japanese corporations joined in the land speculation game. The breakdown of motives disclosed by the bar graph (based on data from the National Land Agency) reveals that between 1987 and 1990, half of all land purchases were purely speculative.

So when land prices collapse this has to be reflected in the price of stocks and shares. In Japan, a 17-year rise in land prices came to an end last year. Prices reached unaffordable levels, and are now being reflected in the fundamentals - a drop in industrial output of over 5% in March compared with a year ago, and an emergency government strategy on infrastructural investment to try and keep the economy buoyant.

In contrast with all the other leading industrial economies, land speculation in Germany was minimal. How, then, do we account for the current malaise of the German economy? The problems, actually, represent a "good news" story. The tensions are due to the Republic's investment in the future of an expanded economy. When the eastern half of the country is tooled up, Germany will be unstoppable not just in Europe, but in the world.

◆ The tensions in the German labour market were predictable - and are explained in terms laid out by Adam Smith in *The Wealth of Nations*. The free market guru demonstrated that when taxes are raised out of labour wages instead of land rents, the distortion in the distribution of net incomes is corrected by the payment of higher wages (which, inevitably, are reflected in higher prices).

The Bonn government (ignoring what Smith had to say about the price-stabilisation impact of a tax on land rents) has chosen to pay for reindustrialisation in the east out of taxes on people's wages and consumption. Result: workers are seeking a rise of 9%, whereas the government (which wants to have its cake and eat it - i.e., higher taxation without price rises) is defending a 4.7% offer. The result will be a compromise, which will still leave Germany better placed to beat the competition when the export markets pick up in 1993.

The political stresses in the European Community will have to be watched closely by investors. EI forecasts a failure to fully integrate the EC economy in the 1990s, and that the strongest opposition will come from an outward polarisation of economic interests from political aspirations in Germany.

German industrialists are already expressing their discontent with the idea of being tied to the anchors of their weaker competitors in Europe. The richest pickings for investors who get in on the ground floor will be in Germany. The other members of the IMF may continue to complain, but the Germans will force them to solve their problems through domestic action: Germany will not carry the can for imprudent economic activity in the rest of the world!

JAPAN: INCREASED LAND PURCHASES WITHOUT IMMEDIATE PLANS FOR USE

