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Low globalisation momentum requires adjustment of German companies' growth strategies

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Germany's economy has greatly benefited from globalisation over the past decades. International business is very important both for firms that export directly and for their indirectly exporting suppliers, many of which are small and medium-sized enterprises. In Germany, almost one third of gross value added and more than one in four jobs depend on exports directly or indirectly. This is one of the findings of a study conducted by Prognos on behalf of KfW Research about the future of globalisation and the growth prospects of German enterprises.

The momentum of globalisation has slowed down considerably since the economic and financial crisis of 2008/2009. Most recently, the coronavirus pandemic hit international trade hard and severely disrupted global value chains. Multilateral negotiations on a new free trade agreement have not yet yielded any results and the process of regional trade liberalisation has also stalled. The political and economic tensions between the US, China and the EU are likely to influence the global trade environment in coming years as well. A renewed globalisation surge currently appears unlikely. This creates a challenge for enterprises to reassess the viability of their business models, realign their export strategies and develop new sales potentials.

The Prognos study identifies three main areas in which German businesses can make adjustments. One option is to focus more strongly on domestic demand in Germany. Here, growth opportunities arise primarily from the megatrends of demographic change and digitalisation, as well as climate and environmental action. Another possibility is to develop new, innovative export goods or services for which international demand can be expected to grow, despite generally slowed globalisation. Advancing digitalisation and the growing importance of climate and environmental action are likely to provide important impetus here as well. A third strategy consists in developing new, promising export markets. Several emerging and developing economies outside existing sales markets in Europe, North America and East Asia offer potential. A number of additional factors make these economies attractive as export destinations, apart from their size and their predicted economic growth.

This offers different starting points for policymakers. One of them is to ensure reliable frameworks for external trade and to return to a more rules-based trade system. Entering into new trade agreements with high-growth emerging and developing economies, further liberalising trade in services and creating a digital EU internal market can contribute significantly to strengthening international trade. More ambitious climate and environmental targets at European and international level can further strengthen global demand for such technologies – and thus the business activities of well-positioned German manufacturers. Appropriate frameworks as well as investment and innovation incentives should be put in place to promote capacity building and expand existing strengths of German enterprises – including with a view to other technologies of the future.

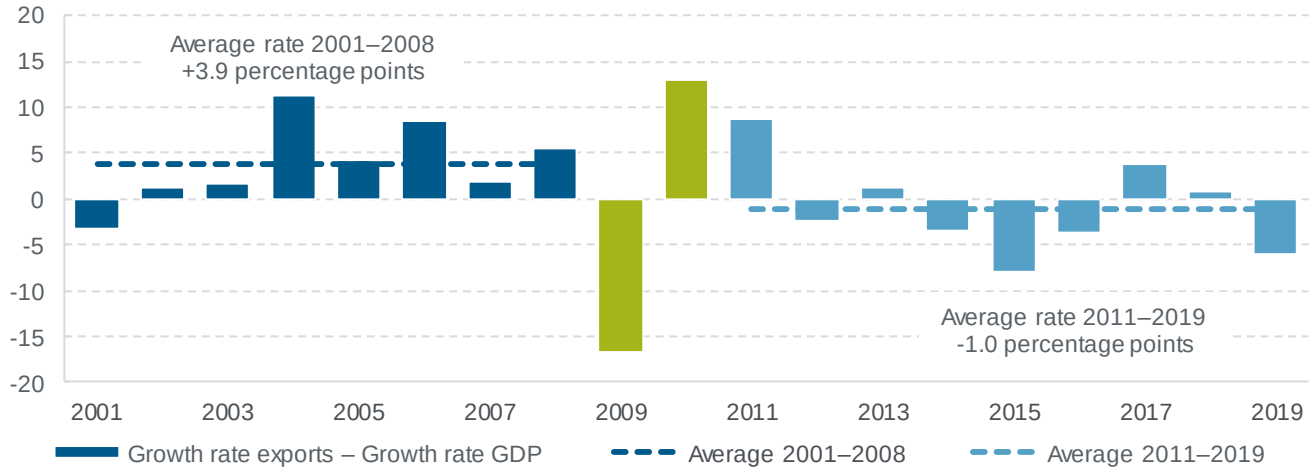
Germany has greatly benefited from globalisation in the past

Over the past decades, Germany's economy has greatly benefited from globalisation. Per-capita income gains from globalisation averaged around EUR 1,400 per year between 1990 and 2018. Only a few countries achieved higher gains from globalisation, including Japan, Ireland and Switzerland. Just under 0.3 percentage points of the average annual per capita growth of gross domestic product of 1.4% was due to closer economic, social and political integration.

A major aspect of globalisation is international trade in goods and services. Exports have so far been an important driver of growth for the German economy and a success factor for German enterprises. Manufacturing firms in particular generate a high proportion of turnover outside Germany. International turnover accounts for more than half of total turnover in automotive and mechanical engineering, pharmaceuticals and the chemical industry, as well as in the electronics industry. International business is of great importance, both for exporting companies themselves and for their indirectly exporting suppliers – many of which are small and medium-sized enterprises. In Germany, nearly one third of gross value added and more than one in four jobs – 28% or 12.6 million – depend on exports directly or indirectly.

Figure 1: Global trade has grown more slowly since the economic and financial crisis

Difference of annual growth rates of global goods exports and global gross domestic product (in nominal values) in percentage points, 2000 to 2019



Source: Prognos (2021) on the basis of UN Comtrade, WDI Indicators

This is one of the findings of a study conducted by Prognos on behalf of KfW Research, which performed an analysis of Germany's international links to develop various scenarios on the future of globalisation and explore ways in which German enterprises can adapt to changed external trade growth dynamics.[1] While the scenarios on the future of globalisation and the effects on growth, value added and employment are the topic of another publication[2], this Focus on Economics takes a closer look at the alternative growth strategies available to businesses amid slowing globalisation momentum. After all, from today's perspective it is hardly likely that the coming decade will see globalisation regain the growth momentum that was observable before the global economic and financial crisis in 2008/2009.

Globalisation momentum had already slowed down before the coronavirus crisis

From the beginning of the 2000s until the economic and financial crisis of 2008/2009, global trade grew strongly compared with global economic output. In the period from 2001 to 2008, the growth rate of global goods exports was an average 3.9 percentage points above the growth rate of global gross domestic product (Figure 1). This development was driven by, among other things, a favourable trading environment, China's accession to the World Trade Organisation and cost reductions in international goods transport. As well, progress in information and communication technologies made it easier to organise production processes across borders and advanced the expansion of global production networks. In addition to global trade, the transnational movement of capital, labour and knowledge also intensified during this period.

After the global economic and financial crisis, however, the momentum of globalisation slowed noticeably. In the period between 2011 and 2019, the annual growth rate of global goods exports averaged one percentage point below the growth rate of global gross domestic product (Figure 1). This is due on the one hand to the pronounced investment weakness that was observable after the global economy recovered from the recession of 2009.[3] On the other hand, no significant progress was made in dismantling tariff trade barriers. Rather, the trade conflict between the US and China led to the introduction of punitive tariffs on both sides. At the same time, the proportion of globally traded goods affected by non-tariff trade barriers, such as import quotas, export subsidies, licences or administrative hurdles, rose from around 7% in the year 2009 to nearly 32% in 2017.

The coronavirus pandemic has hit global trade hard and severely disrupted global value chains

The coronavirus crisis has greatly disrupted global value chains and caused a slump in global trade which turned out to be much sharper than the decline in global economic output. According to estimates by the International Monetary Fund, the volume of global trade fell by -8.3% in 2020, while global gross domestic product dropped by -3.2%.[4]

Germany's foreign trade has also dropped sharply. In April 2020 alone, nominal goods exports were 31.1% lower year on year. Despite a dynamic recovery over the summer, exports remained below pre-crisis levels in autumn 2020 as well. Current economic forecasts predict that Germany's foreign trade will experience a strong recovery in 2021, partly due to dynamic growth in Asia and broad economic stimulus programmes in the US. From 2022, however, the growth rate of trade will close in on the growth rate of gross national product again.[5]

External trade is unlikely to provide much impetus in the future either

From today's perspective, it is unlikely that globalisation will regain strong momentum again in the long term. Multilateral negotiations on a new free trade agreement have not borne any fruit in the past twenty years. The World Trade Organisation appears to have been weakened. The process of regional trade liberalisation has also stalled of late.[6]

The protectionist trends of the past years have undermined confidence in a rules-based trading system. It will take a very long time to restore – if it can be restored at all. In addition, during the coronavirus crisis many states adopted trade policies that could also weigh on trade sentiment in the longer term. The political and economic tensions between the US and China are likely to remain and continue influencing the global trade environment. But foreign trade agreements face foreign policy disputes for the EU as well. For example, the sanctions for human rights violations in China and China's response have made the ratification of the EU-China investment agreement unlikely.

From the perspective of the companies, a broad withdrawal from global value chains as a result of crisis experiences in the coronavirus pandemic is not to be expected. The efficiency gains from the international division of labour are too substantial for that to occur.[7] However, calls for a regionalisation of value chains and the creation of incentives for a more nationally oriented production are being voiced time and again, with some of them falling on fertile political ground. Advances in the areas of automation and robotics could also contribute to greater de-integration, making the re-shoring of production stages attractive.

The Prognos study commissioned by KfW Research also regards slowed globalisation for the period leading up to 2030 as the more likely scenario.[8] In such a scenario, which the study also refers to as a reference scenario, Germany's degree of openness as the sum of exports and imports in relation to gross national product would rise only moderately from 90% in 2018 to 100% in 2030. Labour productivity would grow by around 1.1% annually – also as a result of import competition. In addition to trade in goods and services, this scenario also takes into account international migration.

On balance, taking into account the GDP decline during the coronavirus crisis, gross domestic product would grow by an average of around 0.7% per annum between 2018 and 2030, or 9.1% over the entire period. In this scenario, the growth contribution of net exports is -0.1 percentage points, or almost zero. In the rather unlikely scenario of far-reaching deglobalisation, it even stands at -1.8 percentage points. Net exports provide a positive growth contribution only in the also unlikely scenario of a renewed globalisation surge.

Existing growth strategies may be remodelled in three directions

Should international trade grow only slowly in future, Germany as a heavily export-oriented economy would be hit particularly hard. The weak momentum of globalisation is pushing enterprises to assess the viability of their business models, adapt their export strategies and identify new growth opportunities. This applies primarily to internationally oriented manufacturing enterprises, as well as to many small and medium-sized suppliers and service providers that depend on exports indirectly.

The Prognos study identifies three main adaption options for businesses (Figure 2). One option is to focus more strongly on domestic demand within Germany. Here, growth opportunities arise primarily from the megatrends of demographic change, digitalisation and climate and environmental action. Another possibility is to develop new, innovative export goods or services for which international demand can be expected to grow despite generally slower globalisation. Digitalisation as well as climate and environmental action are likely to provide key impetus here as well. A third option consists in developing new, promising export markets. Several emerging and developing economies outside existing sales markets in Europe, North America and East Asia offer potential in the future. What will be crucial for the attractiveness of these countries as export destinations, however, is not just the forecasted growth of their economies. Many other factors such as the share of manufacturing or the institutional framework likely play a role as well.

Figure 2: Possible strategies of adapting to a generally slowed globalisation

Source: Prognos (2021), own rendition

Stronger focus on domestic demand

In all scenarios explored in the study, private consumption makes the largest contribution to growth – as has been the case on average over the past decades. Depending on the scenario, private consumption contributes 6 to 7.1 percentage points to the gross domestic product growth rate in the period from 2018 to 2030. A decrease in the supply of labour as a result of an ageing society leads to rising real wages and, thus, increasing purchasing power. At the same time, the private and public sector need to invest large sums of money to ensure the sustainability of the economy. Above-average growth in consumption and investment demand can be expected primarily in those areas that are impacted by the key megatrends of demographic change and digitalisation, as well as climate and environmental change.

Demographic change opens up market opportunities

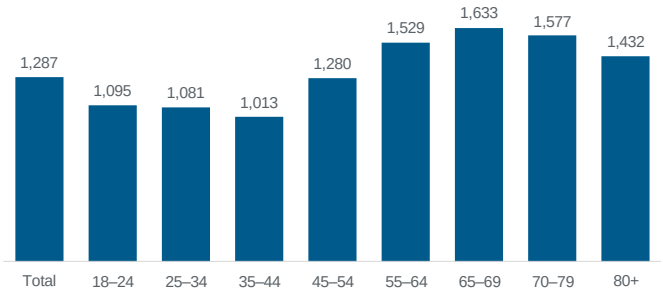
Germany's society is already ageing noticeably. Whereas in 1990 the population aged 65 and older made up around 15% of the population, in the year 2018 their share already stood at 22% or 17.9 million. That trend will continue in the future. By the year 2030, the share of inhabitants aged 65 and older will grow by a further 4 percentage points to 26% or around 21.6 million people.[9]

The population group of older people is not just growing in absolute figures; it also has above-average purchasing power. In 2019, per-capita consumption expenditure of 65 to 69-year-olds stood at around EUR 1,630, almost 27% above the average. Their per-capita consumption expenditure was higher than in any other age group (Figure 3). Furthermore, per-capita consumption expenditure of 65 to 69-year-olds

has grown disproportionately compared with other age groups – by more than 14% from 2013 to 2019.[10]

Figure 3: Older population groups have highest per capita consumption expenditure

Private consumption expenditure per capita per month in euros by age of main income earner (from … to … years).



Source: Household surveys by the Federal Statistical Office, own calculations.

Demographic change opens up new market opportunities for businesses such as service providers in the accommodation, hospitality, recreation and entertainment segments, which account for nearly one sixth of consumption expenditure of older persons. Healthcare and nursing are also likely to see growing demand. The 'second healthcare market' plays an important role here. It features health-oriented services that are not paid for by statutory or private health insurance but represents a private consumption expenditure. These include, among other things, individual health services, fitness and wellness, health tourism as well as, to some extent, sport and nutrition. The share of consumption expenditure on health-related services rises with increasing age – from less than 2% among under 25-year-olds to more than 8% among over 80-year-olds.[11]

Demographic change may also present new sales opportunities for enterprises from the manufacturing sector. Driver assistance systems or electric bicycles are examples from the mobility sector that take into account the needs of older consumer groups. The need for products related to senior-friendly housing are also likely to rise.

According to the Prognos study, demographic change does not just lead to structural changes in consumption demand but also to a need for wider investment in health and care infrastructure. This may benefit construction firms as well as manufacturers of technical equipment. An ageing society also means further growth potential for medical technology.

Digitalisation drives consumption and investment

Another megatrend addressed by the study commissioned by KfW Research is digitalisation. It creates impetus for private consumption. Examples include digital products such as games, music or other content that is accessible via digital platforms, as well as hybrid business models that combine conventional products with digital services, such as a heating system that can be controlled digitally and decentralised through an app.

Digitalisation also leads to high investment needs in the public and private sector. Germany in particular has a lot of catching up to do because internationally the country is only in the middle of the pack. In 2020 Germany only ranked 12th on the Digital Economy and Society Index (DESI) of the European Commission, which measures the progress in digitalisation in the 28 EU countries. The country even ranked only 18th in the adoption of digital technology by enterprises, a sub-index of the DESI.[12] In order to advance digitalisation in Germany, a number of public initiatives and programmes are offering financial support for investment in the development and implementation of digital technologies.[13]

The digitalisation of production processes provides new sales potential, especially for mechanical engineering and plant construction. However, service enterprises, especially those active in the information and telecommunications industry, are also likely to benefit from businesses' growing demand for investment in digital solutions.

German enterprises can also participate in the necessary expansion of digital infrastructure. This includes the expansion of broadband infrastructure, especially the 5G network. Small and medium-sized suppliers of communications technology and electronic components as well as providers of business-related services and construction services can also benefit from this. It also includes the expansion of digital infrastructure in households, enterprises, public facilities such as schools or hospitals and administration. Around one third of municipalities in Germany today regard the existing infrastructure as insufficient for the successful digitalisation of public administration.[14] This is another area with sales potential for suppliers of relevant hardware and software.

Growing demand for climate and environmental technologies

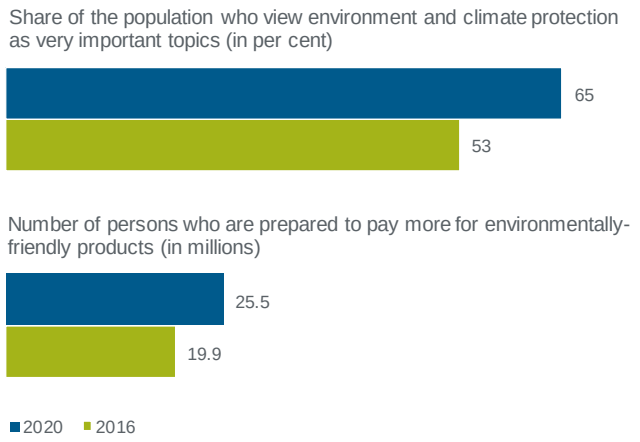
According to the Prognos study, another growth market is emerging from the increasing importance of climate and environmental action. Almost all countries – industrialised, emerging and developing – have committed to significantly reducing their greenhouse gas emissions in the medium to long term under various international agreements such as the Paris Climate Agreement and in national climate action plans. Large investment sums will be required to reach this goal. The Federation of German Industries estimates that as much as EUR 2.3 trillion in additional investment will be required in Germany alone in order to reduce the emission of climate-damaging greenhouse gases by 95% by the year 2050 – assuming optimal political coordination and international efforts.[15] Much more extensive measures will be required in order to reach the more ambitious target of climate neutrality by 2050 that has been adopted under the European Commission's European Green Deal.[16] Investments are also being supported in the field of climate and environmental action under various government programmes.[17]

Already in 2017, enterprises in Germany produced more than EUR 86 billion worth of goods that potentially benefit the environment. Most of them were goods that can contribute to

climate action such as solar cells, components for wind generators, gas and steam turbines, block-type thermal power stations and insulating materials.[18] In light of the intended climate goals and the associated investment needs, demand for climate and environmental technologies should continue to grow in the future. Investment demand in the energy, transport, building and industrial sectors can primarily benefit manufacturing enterprises – particularly in mechanical engineering and plant construction – but also businesses in upstream and downstream stages of value creation such as the construction industry and the services sector.

The megatrend of climate and environmental action can also be expected to influence the structure and momentum of consumption demand. In the framework of the United Nations Sustainable Development Goals and the German Sustainability Strategy 2021, the German Federal Government has adopted the target of raising the market share of products that carry a government eco-label to around 34% by 2030. That share grew from 3.6 to 8.6% between 2012 and 2016 but dropped again slightly to 7.5% by 2018.[19] Looking ahead, new government labels such as the 'Green Button' may produce a steering effect. The growing environmental awareness among the population also points to a growing market for green products. Even in 2020, during the coronavirus crisis, some 65% of the population considered climate and environmental action to be a very important issue – around 12 percentage points more than in 2016.[20] At the same time, the number of persons in Germany who are willing to pay more for environmentally friendly products grew from 19.9 million in 2016 to 25.5 million in the year 2020 (Figure 4).[21] This potential can be harnessed for enterprises in the consumer goods industry.

Figure 4: Environmental awareness is rising among the population



Sources: German Environment Agency (2021), Allensbach Institute for Public Opinion Polling (2021)

Growth abroad through innovative export products

In case of difficult external economic conditions, it can be worthwhile for many enterprises to take a closer look at the domestic market. Nevertheless, many enterprises will not be able to give up their international business. They face the challenge of defying the general slowdown in the momentum of globalisation and identifying market segments in which they can also generate growth in the future with innovative export products.

Digitalisation also provides growth impetus for German enterprises abroad

According to the Prognos study, digitalisation is likely to provide crucial impetus in foreign markets as well. At present, Germany is not among the technological leaders in many information technologies that have future potential, which include the internet of things, artificial intelligence, blockchain and augmented and virtual reality.[22] In some fields, however, German enterprises are in a relatively good starting position that can be further reinforced and converted into export opportunities. These include, for example, process automation, robotics or additive manufacturing, which build on the strengths of German industry in production technologies. Hybrid business models that combine conventional industrial products with digital services can produce growth potential in foreign markets as well.

Digitalisation also provides opportunities for exporting services – and not just from the ICT sector. Growing digital connectedness and digital media such as video conferences which established themselves in the coronavirus crisis also facilitate the provision of conventional services across borders without the need for personal contact, for example legal services, financial and strategic advice, as well as research and development. The share of services in global trade grew already before the coronavirus crisis. In international comparison, services made up a rather small portion of 21% of Germany's exports in 2019. But here, too, trade in services grew faster than trade in goods in the past years. The digital transformation may enforce this trend.

Germany is already the second largest exporter of environmental and climate-smart goods

German enterprises also enjoy a good starting position in the area of environmental and climate technologies. In 2018 Germany was the second largest exporter of environmental and climate-smart goods, with an export volume of EUR 68 billion. This represents a global market share of around 12%. With EUR 82 billion, China was the only country that exported more environmental and climate-smart goods (Figure 5).

Germany's world market share in the subsegment of mitigation and protection technologies stands at a particularly high 23%. These include products or services that help to prevent contamination and emissions at the source, such as filtering and recirculation technology and noise mitigation technology. But Germany's global market share is also comparatively high in the subsegments of water management (17%) as well as energy efficiency and energy conservation (16%).

In the coming years, the commitments of many countries around the world to step up their climate and environmental action will result in a greater need for investment in relevant technologies. This area will be able to realise its growth

potential particularly if a reliable framework is successfully created and financial incentives are provided for environmental and climate investment – both at national and at European and international level.

Global market for electric vehicles is growing significantly – as is the share of German manufacturers

The growing importance of environmentally friendly mobility, in particular, also creates opportunities for German enterprises. In 2020 the number of newly registered electric vehicles rose by around 38% to 3.18 million around the world, a significant increase. Registrations grew particularly strongly in Europe last year, rising by approx. 134%. For the first time, three German automakers were among the six most important manufacturers in 2020. The Volkswagen Group is hot on the heels of Tesla, the largest manufacturer thus far, ranking second in 2020, with BMW and Daimler coming in fourth and sixth, mostly thanks to their sales of plug-in hybrid models.[23] McKinsey predicts that the share of German manufacturers in global electric vehicle production will grow from 18% in 2019 to 29% in 2024. That would make Germany the global market leader, just ahead of China.[24]

According to the Prognos study, this growth also holds opportunities for suppliers in the areas of battery cell and battery module production and power electronics of energy storage systems. Mechanical engineering and plant construction companies can also benefit from the necessary investment in production facilities.

Tapping into new export markets as an alternative

In addition to increasing the focus on the domestic market and developing innovative export products for promising market segments, opening up new international markets can also hold growth potential for German enterprises. Despite the presumably low globalisation dynamics, some economies are likely to grow more than average. Particularly in some countries that were previously not in the spotlight of German export activity, the process of economic development can be expected to create growing import demand in the long term as well.

So far, emerging and developing economies have not been the focus of German exports …

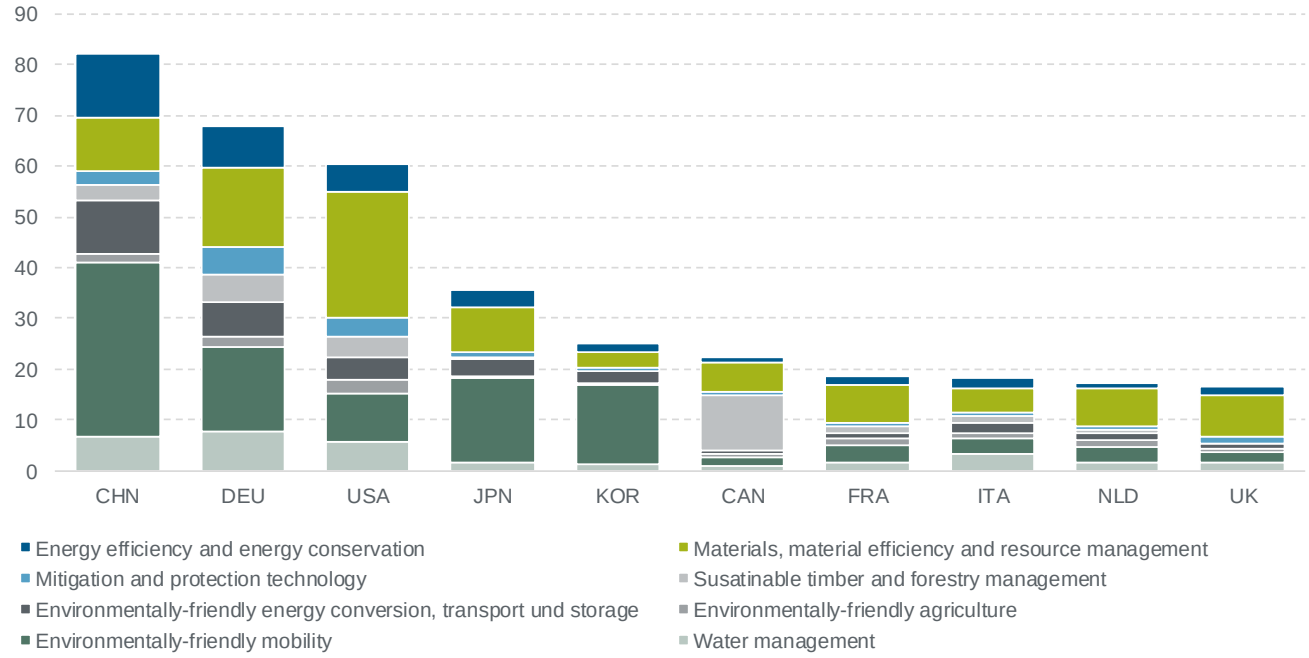
A large portion of German exports goes to other EU countries – around 52% in 2019, not counting the United Kingdom as an important trading partner of Germany. Another one quarter of German exports goes to other OECD countries. Among the non-OECD countries, which include mainly emerging and developing economies, only China has so far succeeded in joining the group of Germany's ten most important international markets. The share of other non-OECD countries in German goods exports remains on a relatively low level of around 12% (Figure 6).

… but they have above-average growth potential

However, non-OECD countries in particular have high growth potential. According to estimates by Prognos, the group of non-OECD countries (not including China) will see their gross domestic product grow by an average 4.2% per annum in real terms up to 2030. China is set to surpass this with a forecast growth rate of around 5.5%. Gross domestic product of the EU countries, in turn, is forecast to grow by an average 1.8% annually, the remaining OECD countries by 2.2%.

Figure 5: Germany is the second largest exporter of environmental and climate solutions

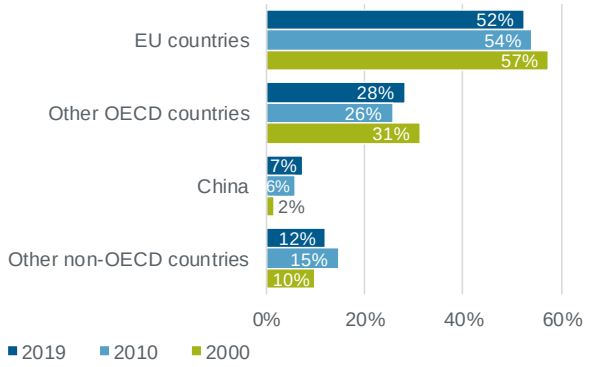
Export volume of the ten largest exporters of environmental and climate-smart goods by individual segments, 2018, in EUR billions



Source: Prognos (2021)

Figure 6: Non-OECD countries are currently secondary markets for German exports

Share of country groups in German exports, 2000, 2010 and 2019



Source: Prognos (2021) on the basis of the Prognos world trade model, UN Comtrade 2020.

For German enterprises, non-OECD countries that have not just high growth potential but a certain size are likely to be of particular interest. The 20 largest non-OECD countries (without China) include 10 Asian countries alone which, with the exception of Hong Kong and Singapore, are predicted to grow annually at rates of 3 to 5.9%. Some African states such as Nigeria and Egypt are also among the largest non-OECD countries and they are predicted to grow relatively strongly up to 2030 (Figure 7). That makes them interesting as potential export destinations for German enterprises.

Numerous factors determine what makes potential export destinations attractive

A number of factors besides size and growth potential determine whether a country may potentially become a new export destination. Different aspects may indeed be of varying importance for different enterprises. What makes an international market attractive may be, among other things:

- the import quota (ratio of imports to gross domestic product), which provides an indication to what extent a country meets its demand from imported goods,
- per capita income, which is relevant particularly for the manufacturers of high-quality and comparatively expensive consumer goods,
- the share of manufacturing in economic activity, an important indicator particularly for the sales potential of exporters in the mechanical engineering and plant construction segment,
- the institutional framework (judicial independence, extent of crime and corruption, protection of property rights, efficiency of public authorities, among other things),
- the country's general business affability (complexity of approval processes, contractual security, investor protection, time and cost of exports and imports, among other things), and
- the existence of a free trade agreement with the EU that makes it easier for German enterprises to trade goods and services across borders.

Comparison of potential export destinations in non-OECD countries shows great heterogeneity

The table shows a comparison of the factors mentioned for the 20 largest non-OECD countries. The more favourable a particular aspect is for German businesses' operations in a country, the higher the country's ranking for that aspect. As the overall picture is very mixed and the individual factors have different importance to different enterprises, an overall ranking is not shown.

India, Brazil and Russia top the list with respect to the size of their economy alone. At the same time, these emerging economies are already important target destinations for German exporters. They receive the highest shares of German goods exports outside the EU and OECD member states.

Many Asian states such as Indonesia, the Philippines and Vietnam are predicted to achieve above-average growth, although starting from a very low per capita income level. The relatively high level of industrial activity in these economies may present opportunities for capital goods manufacturers. However, demand here will likely be more focused on simple, robust machines rather than technologically sophisticated plant and machinery. This challenges many German enterprises to adapt their products to the needs of these export markets.

Other countries offer good growth prospects, but difficult institutional conditions probably make their markets more difficult to tap into, especially for small and medium-sized enterprises. Among these are, in particular, the African states of Nigeria and Egypt, as well as Pakistan and Bangladesh.

Some Southeast Asian countries such as Thailand, Malaysia and Singapore have high per capita incomes compared with the remaining non-OECD countries. Their imports and manufacturing as a share of gross domestic product are higher than in many other emerging and developing economies and their institutional framework is comparatively good. With GDP growth predicted to average 3.5% per year up to 2030, Thailand's economy is likely to develop much more dynamically than those of most traditional export markets. With growth rates of 3.0 and 2.4%, Malaysia and Singapore are also likely to grow significantly more strongly in the coming decade than the average of the EU and OECD member states.

Tapping into new export markets generally poses a number of challenges for German enterprises, including necessary product adaptations, regulatory and bureaucratic hurdles, linguistic and cultural difficulties. At the same time, competition in the new export markets – particularly from China – will likely be just as intensive as in Germany's traditional export markets. Larger and more experienced exporters in particular will probably have the necessary financial and human

resources that are necessary to tap into these markets. They offer them growth opportunities amid generally slower globalisation. Besides, broader diversification of international activities can also contribute to better spreading of risks and, thus, lower dependence on individual countries.[25]

Small and medium-sized suppliers are in a special situation

A changed external environment creates a special situation for the mostly small and medium-sized suppliers. They are dependent on the demand from their buyers and, thus, the economic success of export-oriented large enterprises and corporations. That will tend to make it more difficult for them to adapt their own growth strategy. Nevertheless, they must reassess their business models for their viability and, as indirect exporters, address the challenges of slowed globalisation. One option for them is to diversify their buyer structure more broadly and focus more on customers who supply booming market segments at home and abroad. For larger suppliers, an option might also be to seek new buyers in fast-growing foreign markets.

The challenges businesses face offer starting points for economic policy

A changed external environment and reduced globalisation momentum make it necessary for enterprises to reassess their business models for their viability and tap into new sales potentials. Only then will they be able to make a contribution to growth and prosperity in Germany in the long term. Policymakers and institutions can work to create the best possible enabling conditions and support enterprises in adapting to the changed environment.

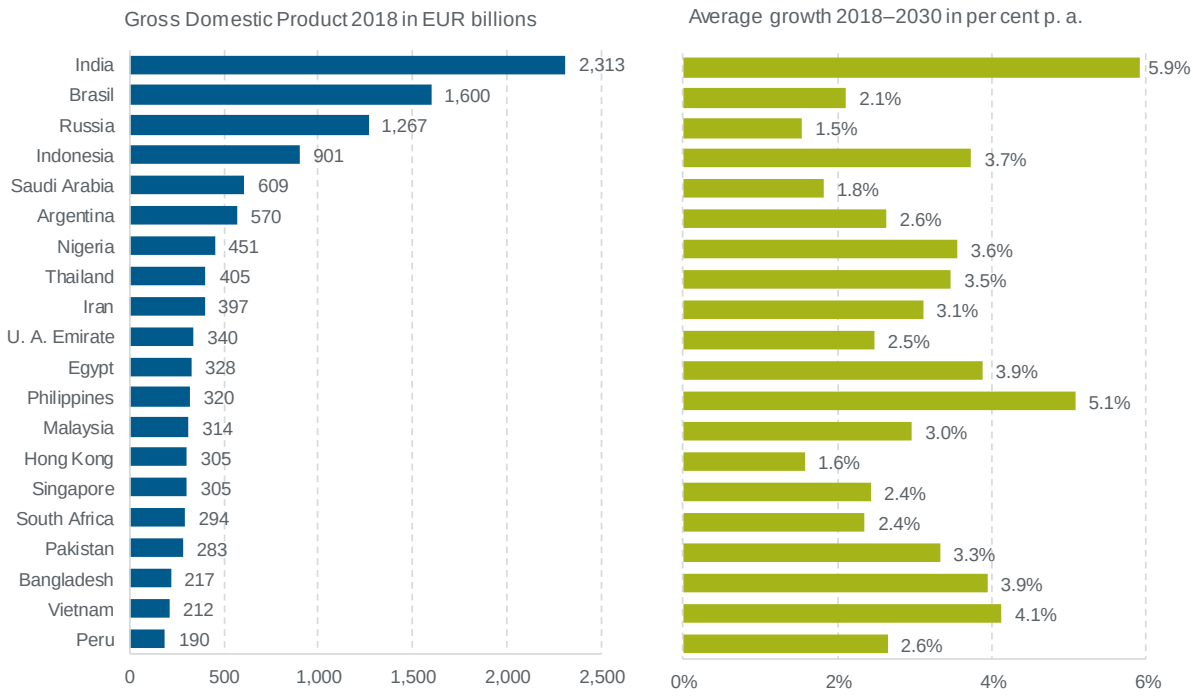
An important field of action for policymakers consists in ensuring reliable external economic conditions. After the trade policy conflicts of the past years, in which the US has played a major role, the time has come to return to a more rules-based trading system. Even if multilateral trade talks should be given preference, other approaches would be to further develop and expand existing bilateral and regional agreements. In addition, entering into new bilateral trade agreements, particularly with fast-growing emerging and developing countries, can open up opportunities for German enterprises, even if a wide range of social and economic interests must be taken into account in the negotiation of such agreements. Germany can influence this through the European Union, which has competence over trade policy.

Trade in services, which continues to be much more strongly regulated and subject to more trade barriers than trade in goods, will also have to play a larger role in this. Further liberalisation could contribute to strengthening trade in digital services. Against this backdrop, the creation of a digital internal market at EU level should be driven forward.

More ambitious climate and environmental targets at European and international level can further strengthen global demand for relevant technologies. This should benefit German enterprises that are already well-positioned. Suitable conditions should be created and innovation and investment

Figure 7: The 20 largest non-OECD countries may offer potential

Gross domestic product and future growth of the 20 economically strongest non-OECD economies (without China)



Note: Economic strength measured by gross domestic product of 2018 in billions of euros (base year 2015).

Source: Prognos (2021)

Table: The 20 largest non-OECD countries differ in attractiveness as export destinations for German enterprises

Ranking by various economic indicators

	Free trade agreement	Gross Domestic Product 2018	Growth 2018–2030	Import ratio 2018	GDP per capita 2018	Industry share 2018	Quality of institutions 2019	Doing Business 2020
India		1	1	11	18	9	13	7
Brasil		2	17	18	8	17	14	16
Russia		3	20	15	7	14	7	6
Indonesia		4	6	14	13	3	8	10
Saudi Arabia		5	18	9	4	10	5	8
Argentina		6	13	17	5	11	15	17
Nigeria		7	7	16	16	18	20	19
Thailand		8	8	5	9	1	6	5
Iran		9	10	19	12	15	17	18
U. A. Emirate		10	14	19	3		3	4
Egypt		11	5	7	14	8	16	15
Philippines		12	2	6	15	4	10	13
Malaysia		13	11	4	6	2	4	3
Hong Kong		14	19	1	2	19	2	2
Singapore	x	15	15	2	1	5	1	1
South Africa	x	16	16	8	11	16	9	12
Pakistan		17	9	13	20	13	19	14
Bangladesh		18	4	10	19	6	18	20
Vietnam	x	19	3	3	17	7	12	9
Peru	x	20	12	12	10	12	11	11

Note: The individual columns show the rankings relative to the remaining 19 non-OECD member states. The colours provide a rough orientation – the more (dark) green the more attractive, the more (dark) blue the less attractive a country is with a view to the relevant factor as a potential export destination for German enterprises.

Source: Prognos (2021) on the basis of the global trade model VIEW+, Comtrade, WEF Competitiveness Index, World Bank Doing Business Index (as at December 2020).

incentives provided for enterprises in order to further expand Germany's technological leadership.

Capacity building should be promoted and existing strengths developed further – not just in environmental and climate technologies but in other technologies of the future as well, such as automotive engineering, production technology, medicine and information and communications technologies. Creating reliable conditions, tax incentives, financial support for enterprises and targeted public demand constitute starting points here as well.[26] With a view to digitalisation, it will be helpful to agree on uniform standards and norms as early as possible, because uncertainty about this is one of the main barriers to digitalisation in enterprises.[27]

Further starting points lie in obtaining information. In order for businesses to develop new growth strategies and adapt to a changing external environment, there is a need to conduct an in-depth analysis and classification of major future trends and their impacts on the business operations of enterprises within and outside Germany. Virtual platforms for information sharing, business networks or advisory services can help small and medium-sized enterprises in particular to recognise the significance of important topics of the future for their business models and identify specific adaptation strategies they could pursue.

Outlook

The international division of labour is of great importance for value creation and employment in Germany. Nevertheless, globalisation is set to develop much more slowly in the coming decade than before the economic and financial crisis. The coronavirus pandemic may potentially have lasting impacts on global value chains as well. Enterprises themselves ultimately decide the further course of globalisation by the way in which they configure their supply and sales relationships. The conditions for it, however, are set by politicians. In other words, they have the capacity to help shape the process of globalisation in a way that promotes prosperity.

[1] Cf. Prognos (2021): Globalisierung in der Krise – Die deutschen Unternehmen brauchen neue Wachstumsstrategien (*Globalisation in crisis – German enterprises need new growth strategies* – our title translation, in German only), Basel. Unless otherwise specified, the statements made in the present Focus on Economics are based on this study. Unless otherwise specified, the figures given in the preceding and following sections are taken from this source.

[2] Abel-Koch, J. and Ullrich, K. (2021): What next for globalisation? Scenarios for Germany's growth model (forthcoming), Focus on Economics No. 348, KfW Research.

[3] Cf. also Abel-Koch, J. and Ullrich, K. (2021), loc cit.

[4] Cf. International Monetary Fund (2021): World Economic Outlook Update – Fault Lines Widen in the Global Recovery, July 2021, Washington D.C.

[5] Cf. German Council of Economic Experts (2021): economic forecast 2021 and 2021, Wiesbaden, and Projektgruppe Gemeinschaftsdiagnose (2021): Gemeinschaftsdiagnose (Joint Economic Forecast) #1-2021 – Pandemie verzögert Aufschwung – Demografie bremst Wachstum (*Pandemic is delaying recovery – demographics are slowing down growth* – our title translation, in German only).

[6] Cf. Antràs, P. (2020): De-Globalisation? Global Value Chains in the Post-Covid-19 Age, NBER Working Paper No. 28115.

[7] Cf. Abel-Koch, J. (2021): KfW Internationalisation Report 2021 – Coronavirus crisis sends SMEs' international business tumbling, KfW Research.

[8] For more on the various globalisation scenarios and associated growth forecasts see Abel-Koch, J. and Ullrich, K. (2021), loc cit.

[9] Cf. Coordinated population projection by the Federal Statistical Office, Variant V1-G2L2W1, as at 5 July 2021.

[10] Cf. Federal Statistical Office (2020): Household budget surveys – Continuous household budget surveys, income, receipts and expenditure of households 2019, Fachserie 15 Series 1, Wiesbaden, and Federal Statistical Office (2015): Wirtschaftsrechnungen - Einkommens- und Verbrauchsstichprobe, Aufwendungen privater Haushalte für den Privaten Konsum (*Household surveys – Income and consumption sample survey, private consumption expenditure* – our title translation, in German only), Fachserie 15, issue 5, Wiesbaden.

[11] Cf. Federal Statistical Office (2020), loc. cit.

[12] Cf. European Commission (2020): Digital Economy and Society Index (DESI) 2020

[13] For example, EUR 5 billion is being made available for the expansion of the 5G network, and another EUR 5 billion is being provided for investment in artificial intelligence. The German Federal Government's implementation strategy known as 'Shaping digitalisation' combines the various initiatives and programmes and is supplemented by the Economic and Future Package adopted in June 2020.

[14] Cf. Brand, S., Steinbrecher, J. and Krone, E. (2020): Digitalisierung in Kommunen: Große Erwartungen treffen auf viele offene Fragen (*Digitalisation in municipalities: High expectations collide with many open questions* – our title translation, in German only), Focus on Economics No. 298, KfW Research.

[15] Cf. Boston Consulting Group (BDG) and Prognos (2018): Klimapfade für Deutschland (*Climate pathways for Germany*, our title translation, in German only), study commissioned by the Federation of German Industries.

[16] Cf. Brüggemann, A. (2021): Transitioning to climate neutrality by 2050: a major challenge for German industry, Focus on Economics No. 322, KfW Research.

[17] The corresponding programmes are enshrined in the Energy Efficiency Strategy 2050 and the Economic and Future Package of the German Federal Government. For example, the CO_2 Building Rehabilitation Programme was increased by EUR 1 billion to EUR 2.5 billion for 2020 and 2021, and a further EUR 7 billion is to be allocated to the development of hydrogen technologies.

[18] Cf. German Federal Environment Agency (2020): Die Umweltwirtschaft in Deutschland. Entwicklung, Struktur und internationale Wettbewerbsfähigkeit (*Germany's environmental industry. Development, structure and international competitiveness* – our title translation, in German only) 2019, updated edition 2019.

[19] Cf. German Federal Statistical Office (2021): Nachhaltige Entwicklung in Deutschland. Indikatorenbericht 2021 (*Sustainable development in Germany. Indicator report 2021* – our title translation, in German only).

[20] Cf. German Federal Environment Agency (2021): Umweltbewusstsein und Umweltverhalten, retrieved on 8 July 2021 from https://www.umweltbundesamt.de/daten/private-haushalte-konsum/umweltbewusstsein-umweltverhalten#stellenwert-des-umwelt-und-klimaschutzes.

[21] Cf. Allensbach Institute for Public Opinion Polling (2021): Allensbach Media Market Analysis.

[22] Cf. Zimmermann, V. (2021): Technologies of the future for Germany: The country is well placed in many areas but some need readjustment, Focus on Economics No. 321, KfW Research.

[23] Cf. Centre for Solar Energy and Hydrogen Research Baden-Württemberg (2021): Elektroautos: Bestand steigt weltweit auf 10,9 Millionen *(Electric cars: Global fleet increases to 10.9 million* – our title translation, in German only), retrieved on 8 July 2021 at https://www.zsw-bw.de/fileadmin/user_upload/PDFs/Pressemitteilungen/2021/pi05-2021-ZSW-WeltweiteZahlenElektroautos.pdf.

[24] Cf. McKinsey (2021): Electric Vehicle Index, retrieved on 8 July 2021 at https://www.mckinsey.de/branchen/automobil-zulieferer/electric-vehicle-index#

[25] Cf. Abel-Koch, J. and Ullrich, K. (2020): Short-term shock with lasting effects: The coronavirus crisis and international value chains, Focus on Economics No. 309, KfW Research, and Abel-Koch (2021), loc. cit.

[26] Cf. Zimmermann, V. (2021), loc. cit.

[27] Cf. i.a. Zimmermann, V. (2019): Business Survey 2019 – More and more businesses have firm plans for digitalisation, KfW Research and Bank Gospodarstwa Krajowego, Bpifrance, British Business Bank, Instituto de Crédito Oficial and KfW Group (2019): Going Digital – The Challenges Facing European SMEs.