

## »»» The crisis as a catalyst for more sustainable economic management

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Authors: Dr Fritzi Köhler-Geib, phone +49 69-7431-2931, fritzi.koehler@kfw.de  
KfW Research, phone +49 69 7431-9888, research@kfw.de

### Starting points for a growth and investment programme for the post-coronavirus crisis phase

#### Motivation

**The coronavirus pandemic has been a seismic shock in every respect.** The virus has spread around the world in a short time, infecting more than four million people and claiming nearly 300,000 lives. In order to prevent it from overwhelming healthcare systems, public life has been severely curtailed in many countries and international supply chains have been cut. As a consequence, historic recessions are being expected in the US, Europe and Germany in 2020. Economic output in Germany could plummet by 6%, a similar decline as in the financial crisis of 2009. Even a two-digit drop is possible.

**Thus, the crisis is setting many things in motion – and creating opportunity for change.** This crisis has forced us to do things we would not have thought possible. It has created a digitalisation drive with remote working solutions and new business models. Most people have also experienced strong emotions of fear for a loved one or for their livelihood. This is precisely where opportunity for change presents itself. After all, life-changing events and emotions of this nature make people question and reassess established views and approaches.

**In order to seize this opportunity for more sustainable economic management, five areas of action will be crucial:**

1. Making the economy more resilient to crises
2. Accelerating the transition to a climate-neutral economy
3. Translating inventiveness and reduced mistrust in digitalisation into productivity growth
4. Continuing to use the advantages of international integration and avoiding a nationalisation of value chains
5. Strengthening Europe

Successful change will require an enabling environment, government support schemes and investment that is consciously targeted at these areas.

**A growth and investment programme that is designed to promote growth and more sustainable economic management at the same time will be a key instrument.** The federal and state governments have so far put together a comprehensive package of economic stimulus measures under supplementary budgets, an expanded guarantee framework, the economic stabilisation fund and special programmes through their promotional banks to preserve the productive structures of the German economy during the crisis. Now the focus is turning to the recovery phase. It is foreseeable that this phase will also require further government support. A growth and investment programme that drives growth and tackles the structural challenges will be worth the effort.

**This paper aims to breathe life into the five areas of action and provide initial impetus for a growth and investment programme that addresses them.** A growth and investment programme of this sort will put Germany in a good position to generate income in the medium and long term as well.

### **Building crisis resilience to successfully get past future crises**

**Germany has generally weathered the coronavirus crisis relatively well so far.** This is owed to the mostly prudent response of all public and private actors. They swiftly introduced and implemented containment measures to save lives and preserve livelihoods. At the same time, the federal and state governments quickly set up a comprehensive economic protective shield that provides financial support for businesses and employees and has made payments available quickly.

**But the crisis has laid bare the vulnerability of our economy and society.** It has made all actors – the state, business community and private households – more aware of how important crisis resilience is. It is in the interest of society as a whole. After all, in times of crisis the state must be able to respond and ensure the continued provision of public services, businesses must be prepared for downturns, both in production and in their procurement and sales markets, and private households must also make certain provisions to bridge unexpected bottlenecks.

**Increased crisis resilience is an important pillar of sustainable development but it comes at a cost.** For an economy and society to become resilient, crisis plans must be taken seriously and adapted and expanded where necessary. What must be kept in mind, however, is that making all-encompassing preparations for all conceivable crisis situations is a sheer impossibility. Crisis resilience cannot be had for free and necessary measures come at a cost. Furthermore, some risks are unforeseeable, either in timing or in impact. Resilience, growth and resource efficiency are therefore not always in a state of balance. Policymakers have an obligation to create the frameworks and incentives in such a manner that risks remain manageable and society can overcome potential crises as well as possible.

**Investment in increased crisis resilience and the transition to sustainable structures will pay off even if it may lead to higher debt.** After all, it secures future growth. The consolidation efforts of the past years are now bearing fruit. Germany's state finances provide scope for growth-promoting investment at all levels of the federation. With expected debt-to-GDP of 72% in 2021, this will remain manageable for the state with scope remaining. The same applies to municipal debt, which accounts for 7% of public debt. The sound financial position of companies, with business debt to GDP of 73% in 2019, and of households (debt to GDP of 54% in 2019) is another good starting point on which to build the structural transformation of the economy and society. The financial situation of the banking sector, with a strengthened equity position and a low loan loss ratio, is another solid basis.

In the key areas of action which we will address below, the aspect of crisis resilience must therefore always be kept in mind because increased crisis resilience is indispensable for a sustainable growth model.

### **Advancing towards climate neutrality and adaptation through efficient climate action**

**The coronavirus crisis provides an opportunity for society to reassess the urgency of the climate crisis.** While attribution research has for years been able to demonstrate that the extreme weather events already occurring around the world – especially their frequency – can only be explained by climate change, the intensity and frequency of such weather events and the damage they cause will increase many times over if global temperatures continue to rise. The coronavirus crisis impressively demonstrates what an acute crisis situation that affects all of society and not just people living along a flooded river or in a stormy area means, as well as what response it requires.

**Using the necessary resources to achieve climate neutrality is also a matter of crisis resilience.** Much greater efforts than those undertaken so far will be required to effectively limit the increase in global temperatures to well below 2°C above pre-industrial levels. According to a new study published by the Potsdam Institute for Climate Impact Research, limiting the increase in temperature is not just a commitment under the Paris Climate Agreement or the German Federal Government's Climate Action Package of 2019 but also economically sound given the expected costs of climate damage and the necessary adaptation measures. In this respect, measures aimed at achieving climate neutrality and adaptation are also an expression of crisis-resilient economic management.

**The growth and investment programme can thus make an important contribution with a view to the necessary public investment and incentives for private investment, particularly in four areas.** A study by the Federation of German Industries estimates the additional investment required to reduce greenhouse gas emissions by 95% by the year 2050 compared with the 1990 baseline or to achieve climate neutrality in Germany at more than EUR 2.3 trillion. One approach is to use public funds to make existing public buildings climate neutral or build climate-neutral new public buildings. Opportunities for promoting growth and climate neutrality while setting incentives for the private sector at the same time lie in the following four areas: 1) transport, 2) industry, 3) buildings and 4) renewable energy.

**A major approach to sustainable mobility is to increase market penetration of electric mobility and develop the necessary charging infrastructure.** A lot of work remains to be done towards climate neutrality in the transport sector, as reductions in CO<sub>2</sub> from more efficient driving technologies have been offset by rising numbers of heavy vehicles and increasing traffic. According to the KfW Energy Transition Barometer 2019, only 1.2% of German households drive an electric car. There are various reasons for this low adoption rate. Yet most electric motors already have a lower carbon footprint than internal combustion engines over the car's life cycle. That is why measures that promote higher market penetration of electric mobility contribute to climate neutrality. Other approaches lie in the expansion of public passenger and freight transport. Implementing technology-based solutions aimed at reducing CO<sub>2</sub> emissions, for example the auctioning of time slots for entering inner cities with cars, can also contribute to this. Thus, promoting sustainable mobility does not just provide benefits for the climate. It also allows sustainable growth markets to be tapped into, most notably for Germany's changing automobile industry. As a result, it also enables the development of innovative services in this area.

**Decarbonisation of industry provides an opportunity to make a substantial contribution to climate neutrality.** Early adoption of climate-friendly technologies such as green hydrogen will tap into future export potentials for German plant technology while making a valuable contribution to climate change mitigation. A market launch will require further public incentives to stimulate investment in industrial scale electrolyzers and boost demand for electricity-based fuels and base materials.

**Energy-efficient refurbishment of existing buildings can achieve higher reductions in greenhouse gas emissions while safeguarding jobs.** Non-residential buildings offer a particularly worthwhile starting point. Although only one in seven buildings fall into this category, they account for nearly half of all greenhouse gas emissions. Offerings that bring down the specific barriers to making these buildings more energy-efficient can, therefore, have a major impact. In residential buildings too one aim of the measures must be to increase the modernisation rate. Increasing the use of heat pumps or enhancing the serial modernisation of energy systems could be one approach. These measures will drive growth in the construction sector at the same time, potentially triggering an innovation surge there.

**Climate neutrality also requires a faster rollout of renewable energy.** This will make energy supplies more crisis-resilient while safeguarding jobs in the domestic renewable energy industry. It will also ensure that sufficient 'green energy' is produced, for example for electric mobility. Besides removing regulatory barriers at federal and state level (e.g. caps on photovoltaic electricity generation, approval barriers), the reintroduction of a consistent nationwide promotion scheme for the expansion of renewable energy could contribute to this objective.

**Indeed, a key issue in relation to incentives for more climate neutrality is CO<sub>2</sub> pricing.** It is a tool that enables a steering effect with the least possible market distortion. It is conceivable that the experience of the current crisis has changed public opinion about a manageable CO<sub>2</sub> price. Given the sharp drops in fossil fuel prices in the course of the coronavirus crisis, cost disadvantages of climate-friendly technologies can be offset by very comprehensive CO<sub>2</sub> pricing. One example of this approach is the envisaged introduction of a national trading system for CO<sub>2</sub> emissions from fossil fuels used in the heating and transport sectors from 2021. This is an important mechanism of an enabling environment for the recovery.

## **Translating inventiveness and digitalisation experiences sparked by the crisis into productivity growth after the coronavirus**

**The crisis has unavoidably aroused the inventive spirit of many enterprises; they have adapted and transitioned business models to digital solutions.** Already 43% of SMEs have modified their range of offerings or business models. Many enterprises have stayed in business during the lockdown by enabling their employees to work from home.

**This creativity and the use of modern technology must be translated into productivity growth and crisis resilience in the future so that we can maintain our prosperity.** Given the demographic change that is occurring in Germany, productivity increases through digitalisation and innovation will be key sources of our future prosperity. In this context it is important to support the start-up sector. The ability to preserve existing expertise in future technologies, e.g. in high-tech or deep-tech start-ups, during the crisis and in the recovery phase is also an important competitive factor. More digitalisation also creates vulnerabilities, for example to cyberattacks, which must be taken into account from the outset in order to eliminate misgivings and seize this opportunity.

**There is a great need for investment in digital infrastructure and training.** Infrastructure investment by municipalities and states in the expansion of the broadband and mobile telecommunication network (5G) is a starting point. It must be accelerated in order to make fast internet connectivity accessible to all, which is a prerequisite for, among other things, the further expansion of remote working capacities, networking collaboration and future services (e.g. autonomous driving). Developing a network, however, involves considerable initial investment combined with high uncertainty. Support schemes for local network owners to build and operate new networks can thus inject additional development impetus. In order to advance the expansion of broadband internet in rural regions in particular, approval procedures and conditions for support also need to be simplified. That will help to match production costs with consumers' willingness to pay for high bandwidths. In order to reduce the skills shortage at all levels of the education system, increased sums need to be invested in training the potential workforce and HR policy measures at enterprise level.

**More innovation requires more financing offers to promote the development of new ideas, business models and digital solutions in enterprises.** Research and development is the basis for establishing future fields of technology in Germany. The efforts made in recent years need to be further intensified. Across the breadth of the economy, innovation and digitalisation barriers in the areas of infrastructure, finance, education and expertise need to be dismantled and new ideas promoted. The formation of technology-based start-ups is another particularly strong driver of the structural transformation towards new fields of technology. In these aspects, appropriate financing offers for businesses are the key.

## **Further strengthening and harnessing international networking for crisis-resilient economic management**

**Maintaining the international division of labour is of existential importance for Germany despite the dependencies on other economies laid bare by the coronavirus crisis.** Shortages in the supply of medicines and medical technology, as well as disruptions to production from a shortage of parts from suppliers abroad, have prompted calls for a nationalisation of supply chains. Furthermore, the downturn in German exports, which slumped by 12% in March 2020 below the previous month's level – the steepest decline since the beginning of the time series in 1990, revealed the country's vulnerability to global shocks in sales markets. But withdrawing from the international division of labour and foreign trade would cause a decline in prosperity. It is estimated that real per-capita income in Germany would be at least 22% lower without international trade. So it makes sense to address the topics of supply security and vulnerability of supply chains and sales markets separately in order to enhance crisis resilience.

**Global risks mean that the topic of supply security needs to be addressed.** With a view to the current pandemic, a starting point could be to create strategic reserves for selected goods such as medicines and medical equipment. The announced EU Strategy for Medicines will also address the security of supply. It would be desirable that considerations at EU level include country-specific crisis response measures, for example when they refer to areas such as intra-European transport, in order to design the aspired security in an efficient manner. As digitalisation progresses, the strategic field of data security and IT infrastructure is gaining importance. Directives and requirements for crisis resilience in this field, e.g. on data storage, are becoming relevant for a growing number of enterprises and could be enhanced and bundled in the future.

**In order for businesses to be able to diversify their risks around value chains and sales markets, they must have access to fair international trade.** A reliable framework for trade in the EU internal market and with non-EU countries will contribute to this, signalling a commitment to the reduction of tariff and non-tariff trade barriers. The EU internal market could also be strengthened by preventing labour mobility within the EU from being bogged down by unnecessary bureaucracy. The latter would also benefit cross-border services within the EU. Besides, advancing the harmonisation or mutual recognition of laws, directives and standards among EU member states would benefit businesses.

**Support in opening up additional procurement or sales markets will primarily help smaller businesses to reduce the risk of supply chain disruptions or turnover losses.** After all, the cost of tapping into markets currently allows most SMEs to maintain relations with only few markets on which they then become dependent. Digital solutions such as platforms could be expanded here and supplement existing offerings. Improved financing options, especially for small-scale international projects, could also be helpful.

### **Strengthening and preparing Europe for future challenges**

**Supporting a stable Europe is in Germany's own interest.** It is only in a strong European Union that Germany can maintain its prosperity and tackle global challenges jointly with the European partners.

**Reaching an agreement on a financial security network to overcome the crisis is a first success for Europe's stability.** The EU has proven its willingness to act, although the tough struggles over financing instruments also make potential braking points clearly visible. Germany, in particular, with its trade-based economic model and a value system based on democratic rule of law, has a great interest in opposing the centrifugal forces in Europe.

**A European Reconstruction Fund provides an opportunity to use the crisis to focus on strategic fields of the future in the same way as a growth and investment programme for Germany.** The European Green Deal and A Europe for the Digital Age are rightly among the priorities being pursued by the EU to avoid falling behind in leading-edge technologies and to sustainably modernise the economy. The EU budget needs to have sufficient funds for investment in green technologies, digital infrastructure (e.g. mobile networks) and expertise (e.g. artificial intelligence). The completion of the banking and capital market union will also play an important role because it will facilitate more crisis-resilient economic management and promote innovation through more private risk sharing, improved shock absorption and venture capital.

### **The crisis as a catalyst for more sustainable economic management**

**It is therefore essential to quickly draw up a growth and investment programme that takes into account the structural challenges of the German economy and conveys a clear idea of sustainable economic management.** From our point of view, the five fields of action described above – resilience, carbon neutrality, productivity growth through innovation and digitalisation, diversified international networking and a strengthened Europe – will be key.