

31 January 2023

Press release

Are globalization and Germany's business model on the way out?

Joint report from BayernLB Research and Prognos says firms' sales markets and supply chains need greater resilience or wholesale change

Berlin/Munich – For BayernLB Research and Prognos, the German business model is under threat. That's why they've co-authored a new report analysing the global environment for German firms and outlining potential ways of ensuring their business models remain viable. The German government, meanwhile, needs to create the right environment to enable Germany's export-oriented businesses to better withstand crises.

For years globalization has been slowing as a result of geopolitical tensions, such as those between the US and China, as well as political shocks such as Brexit. Since the Covid-19 pandemic and Russia's war of aggression in Ukraine, supply chain bottlenecks and new geopolitical threats have further exacerbated the situation, along with inflation and interest rate hikes. For German businesses, it means sales markets and supply chains need greater resilience or wholesale change if firms are still to thrive on the international stage.

"German businesses could profit greatly from the export of climate and environmental technology and should explore relatively untapped sales markets in new geographical areas," says Michael Böhmer, head economist at economic research institute Prognos.

The report underlines that, globally, the **trade in goods** has been stagnating for more than ten years, while **services** have been playing an ever greater role. "Germany has managed to steadily increase its services exports and was thus able to rapidly recover from the 2020 slump, thanks in part to its tourism industry", says BayernLB's head economist Jürgen Michels.

The report also looks at **technology and innovation**, key factors in globalization, comparing international collaboration on patented inventions. In the US and Germany, the volume of such cross-border patent applications has remained largely unchanged. China, on the other hand, is relying increasingly on purely domestic research and development, thereby isolating itself.

On the **capital market** – long a driver of globalization – the report notes that German firms' longer-term direct investments have recovered only slightly, while foreign lending in the German banking sector has fallen, a sign of limited ambition or clout.

As Böhmer concludes, "The outlook for the coming years is unlikely to deliver improvement. Ongoing **deglobalization** – an unravelling of global economic ties – **has become a realistic scenario**. No significant globalization growth can be observed either in the goods trade, in

corporate structures, on capital markets or in cross-border collaboration on innovations. Geopolitical interests are likely to continue hampering globalization.” Consumers and businesses are already feeling the impact, thanks to bottlenecks in supplies of medicines and semiconductors.

The shifting geopolitical environment and the actions of the US and Chinese governments will have a critical impact on the outlook for globalization. A “more of the same” scenario of ongoing geopolitical tensions between Western countries and China seems plausible, as does one featuring more serious geopolitical conflict, perhaps with China launching a military attack on Taiwan. One outcome of such conflict could be that **closed regional or even national value chains emerge**, thereby ushering in a gradual process of deglobalization – leading to more confrontation and less cooperation. This would fundamentally cast today’s internationalized supply chains and value networks into doubt.

“Companies need to adapt their business model to cope with stagnating or even decreasing globalization. This requires firms to **focus less on China** and **policymakers to push for more free trade**”, comments Michels. China, though, is still the most important market for many companies, and **stable political relations with Beijing** remain essential if we are to tackle global issues such as climate change and the war in Ukraine. On the other hand, the West needs to look seriously at the question of **where China is a partner or strategic ally**, and where a competitor or an adversary. “Against a backdrop of growing geopolitical conflict, establishing a **risk management strategy**, ideally at EU level, is surely essential here”, says the BayernLB head economist.

To reduce dependency on China, the authors suggest improving access to second-tier markets, via free trade agreements and investment treaties for instance. They also consider **Vietnam, Brazil, Egypt and Kenya** as possible examples. “A new China is not on the horizon, so **foreign trading will become more fragmented**. There won’t be one path that is right for all companies”, predicts Böhmer.

Although globalization is stagnating across global trade overall, there are specific **services and individual product categories** that buck the trend. Figures in the report illustrate that Germany has particular strengths in **maintenance and repair services** for machinery and in sales of environmental services such as air pollution control, waste management and water services. The rising demand for climate and environmental protection technology, moreover, presents a major opportunity for German businesses – if they can **further develop their technological know-how**. It could also be worth looking anew at **the domestic market in Germany and the EU**, where there’s little danger of geopolitical risks and supply chains are more manageable.

When it comes to global trading, German companies – especially those in the **pharmaceuticals, chemicals and food industries** – will need greater resilience, while a rapid and comprehensive expansion in low-cost, low-carbon energy is required if energy-intensive manufacturing industries are to continue operating competitively in Germany.

Last but not least, fundamental shifts in the geopolitical environment underline that **robust IT infrastructures, emergency plans** and more autonomous personnel teams are required, while policymakers too need to act to ensure that critical infrastructure, especially for energy supplies and digital services, is more robust.

The full report is available at: prognos.com/german-business-model2023

Contacts:

Eike Schrimm
Communications Officer
Prognos AG
Telephone: +49 899 541 586-711
Mobile: + 49 151 235 049 07
E-mail: presse@prognos.com

Matthias Lücke
Press Officer
BayernLB
Telephone: +49 89 2171 21302
Mobile: +49 170 7879 314
E-mail: matthias.luecke@bayernlb.de