Global Counsel

German industrial strategy: big firms for big challenges?

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Summary

Germany's economy minister, Peter Altmaier, has presented a draft "national industrial strategy 2030" that seeks to formulate a response to fiercer international competition. It is the first time that a German government has sought to define a national and European industrial strategy. Altmaier's proposal is thus an expression of a shifting cross-party consensus, largely driven by a feeling of growing exposures of German industry. His plan presents a defensive toolkit that focuses on large players. He proposes laxer anti-trust rules to allow the creation of national and European champions and a "national participation facility" to prevent strategic takeovers of German companies. His plan also includes an offensive element to allow the state to take an active role in promoting the development of key technologies. The reception of Altmaier's draft strategy in Germany has not been smooth and cabinet is expected to approve a revised version in September. Ahead of the European Parliament elections and Germany's EU presidency in 2020, the document is nonetheless an important statement of intent for how EU policy levers might be repurposed. Berlin's pivot to a more traditionally 'French' interventionism signals a rebalancing of policy preferences following the UK's sharply diminished role.

Peter Altmaier, Germany's economy minister, has started a national debate about industrial policy. His draft "national industrial strategy 2030" attempts to formulate a response to what he sees as fiercer and partly unfair competition from the US and China. Besides a simple quantitative target - manufacturing should contribute 25% to German gross value added by 2030, two percentage points more than today - the strategy presents a defensive toolkit aimed at making European industry fit for the next wave of technological disruptions.

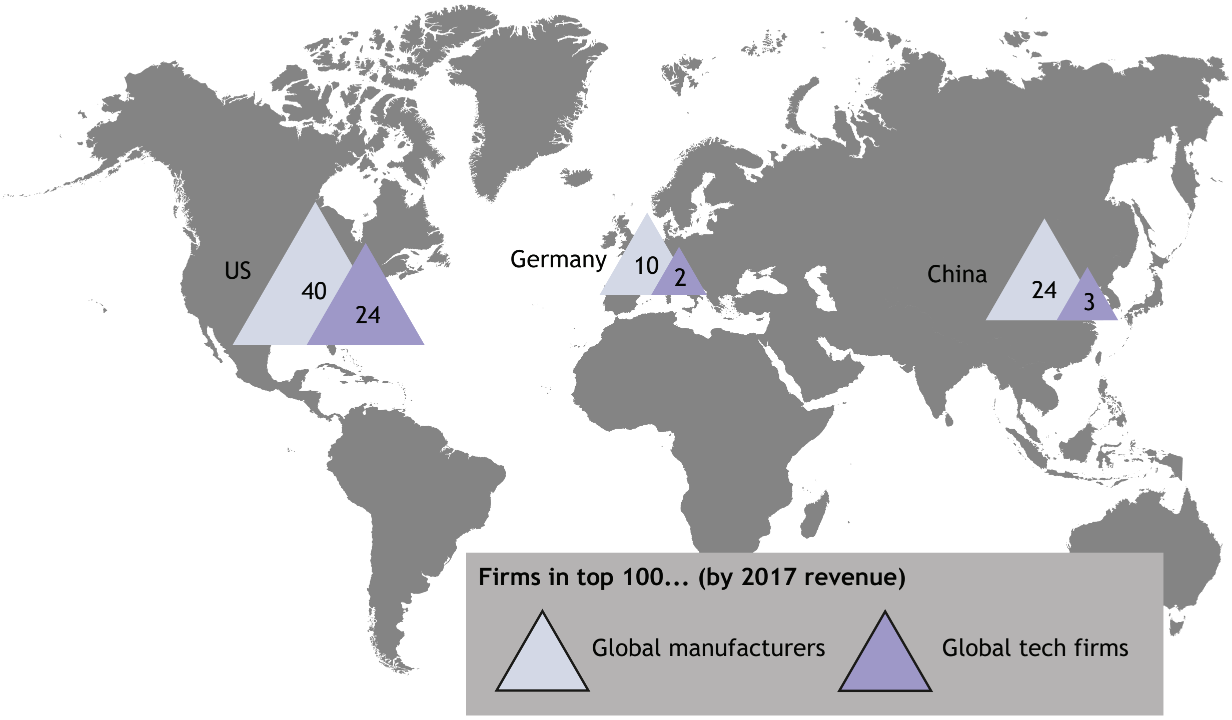
Altmaier's approach suggests that he, and a growing number of German policymakers, do not believe that market forces will enable Germany and Europe to catch up. He proposes to relax competition rules to create European champions able to compete globally in strategic sectors. He also envisions an active role for the state in developing and protecting key technologies and supply chains in Europe. In many respects, Altmaier seeks to define a new German and European industrial policy– a task that no previous German government has attempted so openly.

A shifting consensus

Since then economy minister, Ludwig Erhard, first formulated the principles of Germany's modern social market economy in the 1950s, the state's role in the industrial sector has largely been confined to setting the legal framework for effective competition and funding early stage research. Of course, Germany has always had some form of industrial policy, especially during reunification, even if no one really called it as such. But aversion towards state planning in the sector has been widely shared in government and among both mainstream parties.

The reason for a shift in this cross-party consensus and the support from business for a strategy to address the new competitive landscape is a changing perception of Germany's strengths and exposures. When China's Midea acquired Kuka in 2016, it triggered a growing sense of insecurity within influential parts of the political and business class. The car industry, which ran a €113 bn trade surplus last year, has seen its technological lead shrinking quickly as challengers such as Tesla dictate new market trends. Germany's long and closed value-added chains in automotive manufacturing may be on the verge of disruption, with high value-added production shifting to the US or more likely China.

Fig 1: Global manufacturing and tech firms



Altmaier believes that the current trend is structural, not cyclical and temporary. He warns of a path dependency that threatens Europe's long-term "technological sovereignty". Unless Europe catches up quickly, he argues, it will fail to develop the products and sectors based on next-generation technologies. Artificial intelligence is one reason. The widely held view in Berlin is that Germany is already too late to develop consumer AI. The large US and Chinese tech companies already have such an advantage in the collection of consumer data that they are set to dominate consumer AI for the foreseeable future.

The industrial application of data, platforms and AI is thus perhaps Germany's real battle. This is much harder to develop than its consumer counterpart and is at an earlier development stage. It is also a field where Germany, a leader in industrial robotics, can build on existing capabilities. But China and the US are increasingly becoming strong importers and fast adopters of robots in industry. Beijing's Made in China 2025 strategy envisions producing 50% of industrial robots domestically by 2020 and 70% by 2025.

Size matters!

Altmaier's solution is size: European companies need to have the critical scale to compete internationally. His strategy shifts the traditional focus of German economic policy from private SMEs – or the *Mittelstand* which forms Germany's industrial backbone - to large players. This new focus on a French-style coordination of large, state-affiliated industrial giants, would have been seen as impracticable and undesirable by most German ministers only a few years ago.

The consequences of this shift are potentially far-reaching. Altmaier proposes reforms to European subsidy and competition rules. Instead of focusing on competition at a national or regional level alone, competition authorities should be more flexible in merger rulings in sectors where size is important for participating in global competition. Despite the proposal's lack of detail, Siemens likely welcomed it just days after the European Commission blocked its planned merger with Alstom. Altmaier also states that the survival of some of Germany's largest companies – he specifically mentions Siemens, ThyssenKrupp, Deutsche Bank and the car producers – is in the country's national political and economic interest. A few lines further down, he proposes that a "national participation facility" could be set up to prevent strategic takeovers by foreign (state-backed) companies to acquire key technologies.

The strategy also has an offensive dimension. It envisions an active role for the state in forging companies in key technological sectors. Altmaier is very clear that Airbus is a model for other sectors. He proposes that the government take the lead in the creation of a consortium to produce car batteries, for example. He also envisions that the state could take a direct stake in companies operating in strategically important sectors, such as internet platforms, autonomous driving technology and AI. His proposal for a full assessment of industrial supply chains and Europe's dependence on foreign technology suggests he sees a broad role for the state in future. This particular proposal was supported by 17 other EU member states in their joint declaration of December 2018.

Fig 2: Altmaier's key proposals

Measure	Comment
Changes to EU competition rules	▪ Consider global competition in anti-trust rulings on the EU level to allow the creation of national and European champions
National participation facility	▪ Allow the state to acquire a direct share in companies with critical technology to prevent a foreign takeover motivated by strategic reasons such as technology transfer ▪ The facility needs to have a fixed amount of capital that it can deploy, and the state should divest over time, likely when European buyers can be found ▪ The government needs to report to the Bundestag on a regular basis about the facility's activities
Direct technology promotion	▪ Allow temporary subsidies for companies that develop and produce key technologies ▪ Government can take a direct stake in, or promote the creation of, companies in key sectors, along the Airbus model
EU Council of industrial ministers	▪ Establish a council formation that combines key aspects of industrial policy, such as competition, trade, telecommunications and energy. This could correspond to a new commission vice president role

Ordnungspolitik pushes back

The reception of the Altmaier plan has not been smooth. Altmaier clearly underestimated the task when he promised a strategy in the autumn. His own civil servants had different ideas, leading Altmaier to write the plan himself. The result was a flawed process that led to a haphazard document with obvious gaps and inconsistencies. In the end, he opted to put out preliminary proposals for discussion, rather than a detailed plan. The minister's own economic advisers have criticised some central elements - such as the 25% target - for failing to recognise that new digital companies often combine services and manufacturing.

Altmaier also released the strategy without the full support from his own party, the Christian Democratic Union. While Merkel and the new CDU chair, Annegret Kramp-Karrenbauer, supported Altmaier, the head of the CDU/CSU group in the Bundestag, Ralph Brinkhaus, and his deputy, Carsten Linnemann, who heads the CDU's Mittelstand group, are currently preparing their own proposal. The CDU's pro-business wing senses that Altmaier's approach is an expression of years of grand coalition and would not have been possible in coalition with the liberal FDP, which has since used the strategy to question the CDU's credentials on economic policy.

Business associations have also voiced their frustration with the CDU minister. The Confederation of German Industry, or BDI, published its own response to counter Altmaier's redefinition of Germany's social market economy. The body raised a number of areas where improving business conditions and entrepreneurial freedom would help companies more than state activism. One is energy policy, where state planning has resulted in high energy prices despite large government subsidies, putting energy-intensive industries at a disadvantage. Another is corporate tax, where the BDI sees German competitiveness impacted by US corporate tax cuts. SME associations have been even less diplomatic, with the association of family businesses criticising Altmaier's approach as "anti-Mittelstand policy".

This prioritisation of activism over reform is a notable feature of this whole process. There are reasons why this is the case. Merkel has sought to avoid unpopular reforms and her long-time coalition partner, the Social Democrats, are rather looking to reverse – at least nominally - the reforms of the Schröder years. This perhaps explains why, for instance, reforms of the rigid labour market considered a major impediment to innovation and technology adoption are not mentioned in Altmaier's plan.

Domestic criticism of Altmaier's strategy doesn't mean his ideas will die. The timing of its release ahead of the European Parliament elections, and the proposal of a council configuration of industrial ministers, are a clear sign that Altmaier and others in Berlin want to shape the new European Commission's priorities and perhaps lay the ground for the German EU presidency in 2020. To do this effectively, they believe that even closer cooperation with France is needed. This explains why Germany and France released a manifesto for a European industrial policy just days after Altmaier released his national document. It is also reflected in a conscious decision to pursue a more 'French' strategy in Germany. The departure of the UK from the EU potentially provides more political space for such an approach to get traction.

Germany's cabinet is expected to approve Altmaier's final strategy after the current consultation phase in September. The document will look markedly different. It will likely make more mention of the Mittelstand and market principles. It will also pledge to constrain the state's role in industrial policy. But given the current trends in Germany and Europe, it won't hide a preference for a dirigiste role for government, and big firms to address big challenges.

This Global Counsel Insight note was written by Thomas Gratowski, Practice Lead at Global Counsel.

To contact the author, email:
t.gratowski@global-counsel.co.uk

The views expressed in this note can be attributed to the named authors only.

A: 5 Welbeck Street, London, W1G 9YQ
T: +44 (0)203 667 6500
E: info@global-counsel.co.uk
www.global-counsel.co.uk
@global_counsel