McKinsey & Company

1964 2024 years in Germany

A pivot for Germany

All for growth and growth for all

September 2024

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Key takeaways

Economic growth is not an end in itself; rather, it is a prerequisite for individual opportunities and a stable, successful society.

To achieve this pivot to growth, additional **investments** of €330 billion per year until 2035 are required, with approximately 70 percent coming from private sources and 30 percent from public sources.

The more **stakeholders** are invested—literally or figuratively—in the pivot to growth, the more likely it is to succeed; and if it does, everyone stands to benefit.

Germany has the potential to increase **the value of its economy** substantially, potentially doubling it from around €12 trillion today to over €24 trillion by 2035.

A **dual strategy** can help mobilize more capital: a stronger focus on dynamic sectors ("shift") and enhanced productivity across all sectors ("lift").

Improving **economic conditions** can make Germany more attractive to investors. German CxOs identify a more flexible labor market as the most important prerequisite for increased investment.

Seizing the moment

For many years, the German economy enjoyed steady expansion. From 2010 to 2019, for instance, real gross domestic product (GDP) rose by an average of 1.7 percent annually. This sustained growth drove increases in household incomes[1] and afforded the government flexibility to uphold and enhance social security systems. However, recent years have seen a marked slowdown. The German Council of Economic Experts (Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung) expects a mere 0.6 percent in annual economic growth on average through 2030.[2] At the same time, Germany is facing substantial challenges, ranging from the climate transition and demographic shifts to a tense geopolitical landscape with profound implications for trade, supply chains, and security. Furthermore, the German economy trails behind in numerous indicators when benchmarked against international peers (see text box: "Fast facts on Germany's competitiveness"). Despite these headwinds, our analyses suggest that a pivot to growth is within reach. If Germany unlocks more capital for investment and drives sustainable economic renewal, it can achieve what currently seems unattainable.

Growth benefits everyone

Imagine a future where every job posting attracts a wealth of qualified applicants. Where dedication and flexibility in the workplace are met with competitive salaries and clear paths for career advancement. A future where daycare spots are plentiful, affordable housing is readily available, and nursing homes have ample capacity. Schools are equipped with state-of-the-art technology, serve nutritious meals to all students, and have sufficient teaching staff. Healthcare is accessible, with quick doctor's appointments even without private insurance, and the nation is well prepared for future pandemics. Studying at top universities and research institutions is within reach, eliminating the need to go abroad. Talented and motivated individuals—whether they are scientists, entrepreneurs, artists, or athletes—receive the support they need to thrive. And cellular dead zones, potholes, and budget deficits are relics of the past.

Is this vision achievable? Not if the German economy remains stagnant. However, with increased economic growth, the potential for improvements that benefit the country and its people expands significantly. Growth is not an end in itself; it is a prerequisite for individual opportunities and a stable society—with excellent

healthcare, robust infrastructure, a strong education system, and adequate reserves for times of crisis. Sustainable growth, mindful of nature and the planet's limited resources, is essential to secure and enhance the quality of life that many have come to take for granted. And growth benefits everyone: companies, their employees, public institutions, the population—the entire nation.

The current challenge is stagnant economic growth. The German economy, despite being the world's third largest, is currently experiencing a significant slowdown. Over the past four years (2019 to 2023), GDP growth has been negligible, with a compound annual growth rate of a mere 0.1 percent.[3] Real wages have taken a hit, declining by a compound annual rate of 1.3 percent.[4] Looking ahead to 2024, projections suggest that GDP growth will remain minimal.[5] The impact of this economic stagnation is already evident and will likely become more pronounced if this trend continues unchecked.

Germany from an investor's perspective: The value of economic activity

This study evaluates the German economy through the lens of an investor. The central question is: How does Germany stack up against other investment opportunities? To address this, we have assessed the German economy using the same metrics investors apply to companies and other investment options. Our calculation aligns with capital market logic, capturing the value of current economic activities within Germany and the future potential of the German economy. This assessment spans all economic sectors, from production and services to the public sector. The first component of our calculation is the current operating surplus (EBIT) generated in Germany, reflecting the value of today's economic activity. The second component is the anticipated future surplus of German companies, expressed through EBIT multiples.

The investor's perspective is driven by the understanding that maintaining Germany's high standard of living and tackling future challenges hinges on making the country more attractive to investors. More investment could yield benefits nationwide, since increased economic growth typically also boosts employee salaries and expands the fiscal flexibility of public institutions.


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Fast facts on Germany's competitiveness

Germany's economy is ranked **24th** out of 64 in the IMD Competitiveness Ranking—a decline from 10th place in 2015[6]

Energy prices are **2x** as high as in the US and France[7]

Labor costs are **20%** higher than the EU average[8]

Productivity (GDP per hour) is **30%** lower than in the US[9]

Germany is ranked **18th** out of 38 OECD countries in employee mobility[10]

On average, each employee works **450** fewer hours per year compared with the US[11]

The tax and social security burden on labor income is **13 pp** higher than the OECD average[12]

Obtaining permits for heavy transportation takes **6–12x** longer than in the Netherlands[13]

Public gross investment is **1/3** less than the OECD average[14]

Germany has **24** start-ups per 10,000 inhabitants—compared with 116 in the US[15]

The venture capital investment share of GDP is **8x** lower than in the US[16]

Public education expenditure (share of GDP) is **1/3** lower than in Sweden[17]

If Germany fully harnesses its potential, the value of its economic activity could surge to ~€24.5 trillion by 2035.

Unlocking growth potential

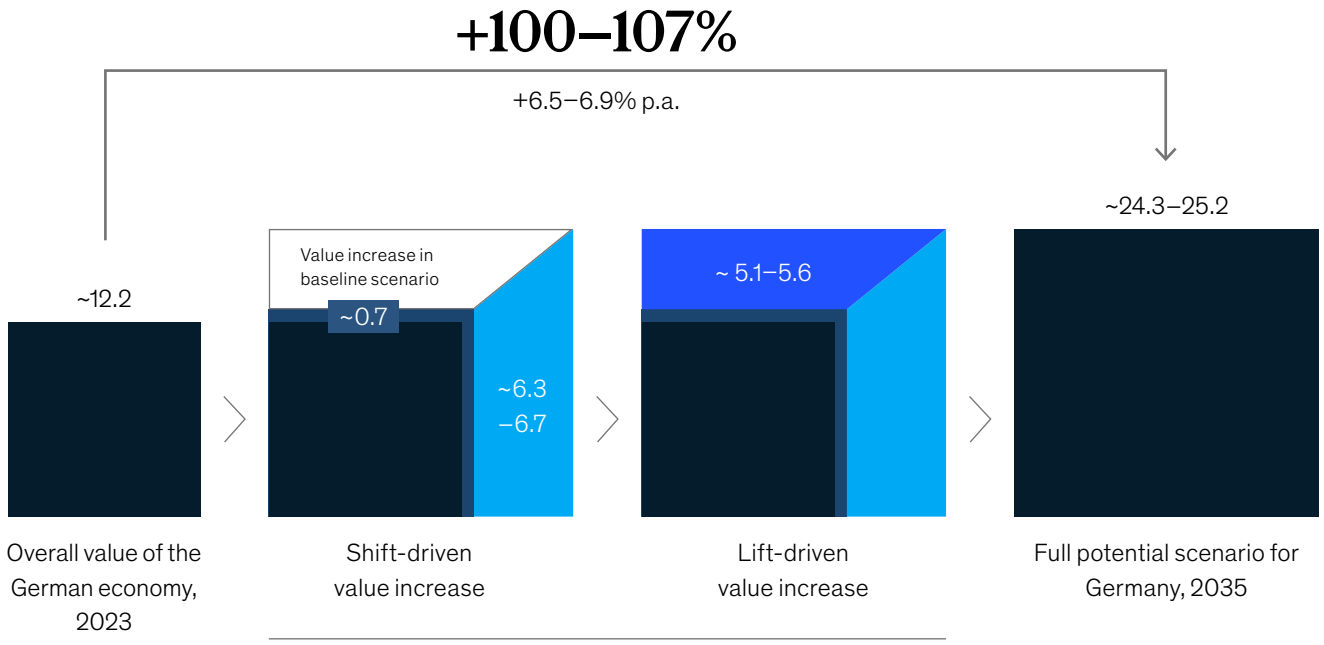
Without significant changes, the value of the German economy (see text box: "Germany from an investor's perspective") is projected to grow only marginally over the next decade, from €12.2 trillion in 2023 to €12.9 trillion (in current prices) by 2035 (baseline scenario). This sluggish growth could accelerate the departure of industrial companies to other countries. For instance, calculations by BDI (Bundesverband der deutschen Industrie; Federation of German Industries) suggest that a fifth of Germany's industrial value creation is at risk in the medium term.[18] If this trend continues, the current high standard of living could be jeopardized, especially considering rising healthcare and pension costs. Without additional economic growth, employee contributions to the pension insurance system would need to increase by nearly 4 percentage points.[19] Moreover, further increases to the federal subsidy for pensions would be necessary. This subsidy already constitutes more than 21 percent of the total budget and is the largest single expenditure item.[20]

If Germany fully harnesses its potential (full-potential scenario), the value of its economic activity could surge to approximately €24.5 trillion by 2035 (Exhibit 1)—essentially doubling the value of the entire economy. In terms of private wealth,

Exhibit 1

Shift and lift contributions to value increase

€ trillions



Shift and lift value creation potential

(Shift = new activities with greater growth potential, Lift = efficiency gains in existing activities)

Source: Deutsche Börse AG (German Stock Exchange); German Federal Statistical Office; S&P Capital IQ; national accounts; German Bundesbank; Finance Magazine

Germany could ascend from 17th to sixth place in international rankings, joining the likes of Australia, Denmark, and New Zealand.[21] Moreover, the government would see an additional €410 billion in annual revenue, assuming tax rates remain constant. This financial boost could empower Germany to fortify its social security systems and tackle pressing challenges, from climate change to infrastructure renewal.

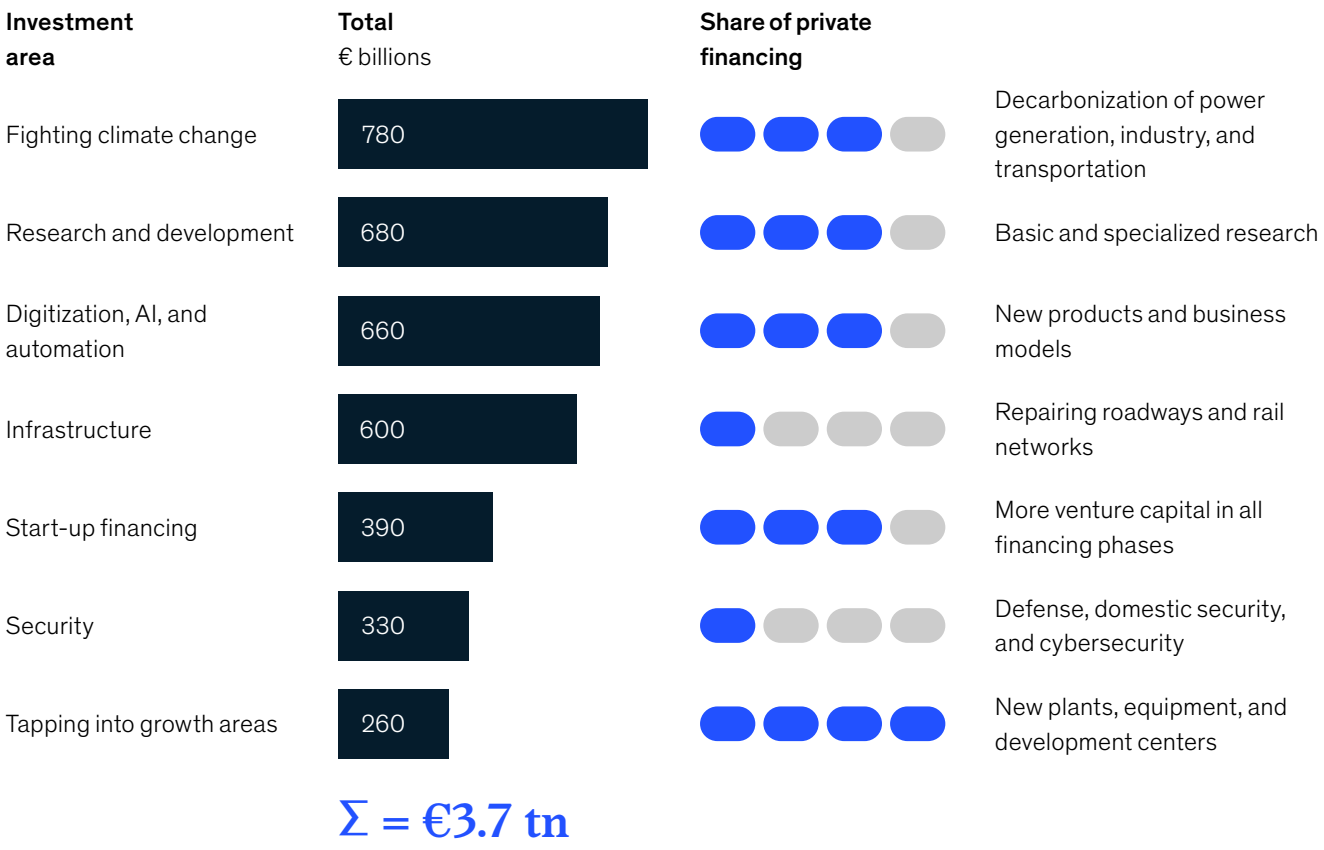
Germany's past shows that growth is attainable even in trying times based on targeted investments. The Federal Republic of Germany has twice boosted prosperity by means of substantial private and public investments—first during post-war reconstruction and later during reunification. In the 1950s, for instance, GDP grew by an average of 8 percent annually. Similarly, in the years following reunification, Germany achieved real GDP growth exceeding 5 percent per year despite considerable challenges. While history proves that a pivot to growth is feasible even under adverse conditions, it does not provide a blueprint for the future. The time has come for a new strategy.

Germany's past shows that targeted investments can drive growth even in challenging times.

A potential strategy

Increased investment is crucial to stimulate growth in Germany. Annual investments of around €330 billion are needed to achieve the ambitious objective of doubling the value of Germany's economy, predominantly from the private sector, according to our analysis. This is on top of the €950 billion already invested annually. The €330 billion equates to approximately 8 percent of the current GDP. Key investment areas include fighting climate change, fostering research and development, and driving technologies such as digitization, AI, and automation. Cumulatively, the additional investment requirement totals €3.7 trillion up to 2035 (Exhibit 2). In our scenario, around 70 percent of this amount would need to come from private sources, slightly reducing the private sector's proportional share compared with current levels, since many of the needed investments fall within the public domain.[22]

Exhibit 2
Investment needs in the maximal scenario



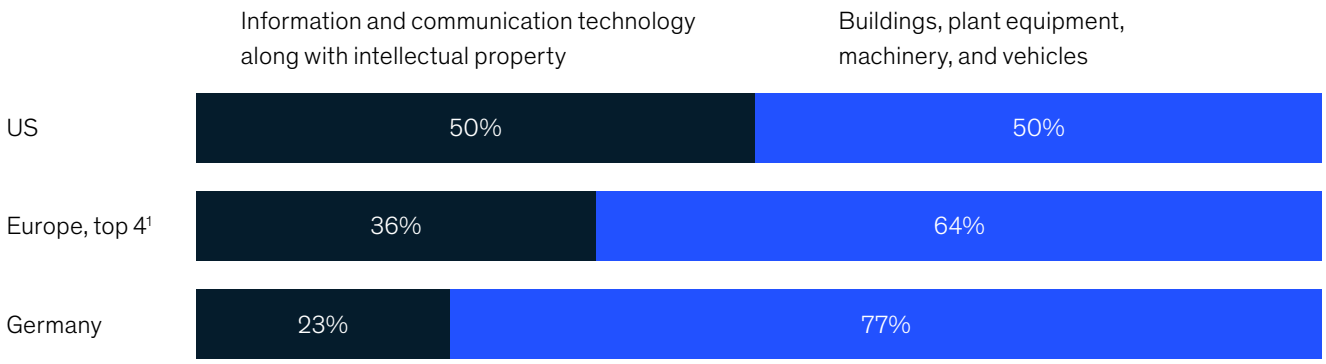
Source: German Federal Ministry of Defense; Global Entrepreneurship Monitor 2024; IMK Macroeconomic Policy Institute; OECD; McKinsey (2021): Net-zero Germany; McKinsey (2024): Zukunftspfad Stromversorgung (Pathway to the Future of Power Supply)

Presently, Germany is underinvesting in growth. Its share of gross fixed capital formation in GDP is marginally below the average of the 38 OECD countries.[23] More critically, Germany allocates minimal funding to dynamic sectors. For instance, in the United States, about half of all gross fixed capital formation is directed toward high-growth areas like IT, communication technology, and intellectual property. In Germany, this figure is less than a quarter (Exhibit 3).[24] Here, investments are primarily channeled into buildings, plant equipment, machinery, and vehicles.

Exhibit 3

Investment classes by country

Type of assets in total gross fixed capital formation



1 Average of values for Belgium, the Netherlands, Norway, and Sweden; no data available for Switzerland

Source: OECD Statistics

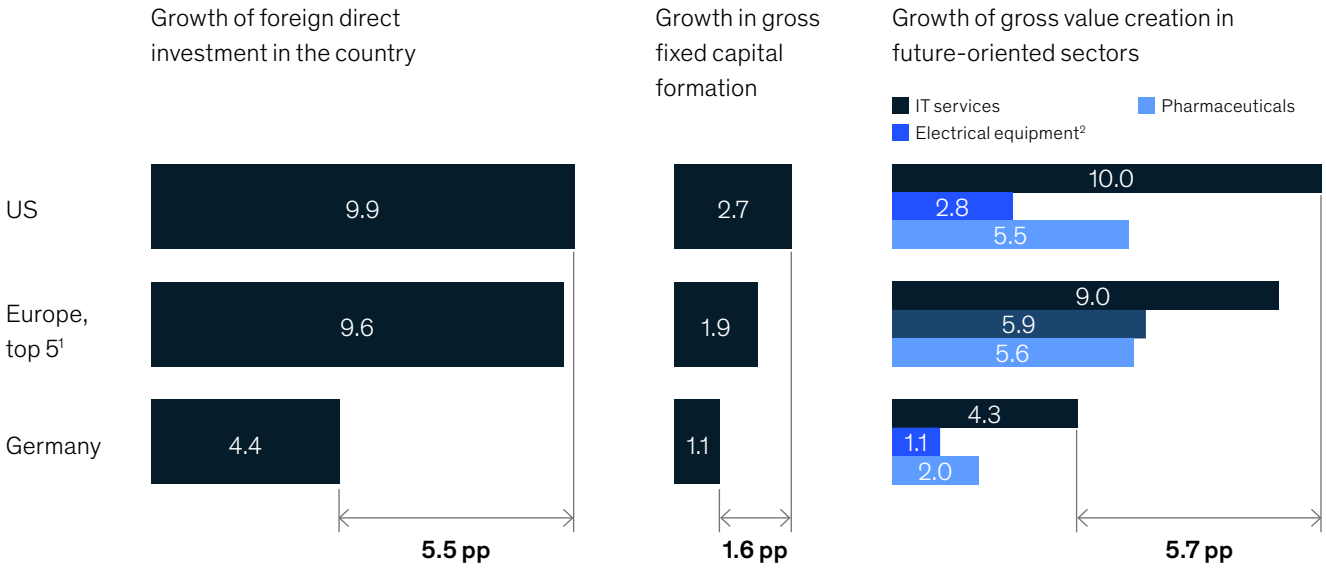
At the time of writing, the downward trend persisted. Between 2010 and 2015, Germany's gross fixed capital formation grew at a real annual rate of 2.2 percent. From 2015 to the present, however, this growth has slowed to just 1.1 percent per year.[25] This recent pace not only lags significantly behind previous years but also trails that of the United States and high-growth European countries. Moreover, Germany has slipped behind its peer countries in terms of foreign direct investment (Exhibit 4).

The root cause of the lack of investment in Germany is the fact that returns are uncompetitive by international standards. Investors—both domestic and foreign, spanning all sectors and sizes, from small and medium-size enterprises to large corporations—compare potential investments in Germany to opportunities elsewhere. Consequently, only attractive returns will enable Germany to compete globally. They currently fall short; for instance, returns in the United States are approximately 30 percent higher.[26]

Exhibit 4

Investment and growth by country

Compound annual growth rate, 2015–22, percent



1 Average of values for Belgium, the Netherlands, Norway, Sweden, and Switzerland
2 Production of data processing equipment along with electronic and optical products

Source: OECD Statistics

As a result, substantial capital leaves Germany. In 2023, the net outflow, after accounting for foreign capital flows into Germany, reached nearly €250 billion.[27] This negative capital balance mirrors Germany's high export surplus, which exceeded €200 billion in 2023.[28]

To attract more investment, Germany would benefit from the prospect of growing revenues and profits. A dual strategy could reignite growth:

Shift—prioritize dynamic, future-oriented sectors. By leveraging its strengths to secure a strong position in globally dynamic, high-growth sectors, Germany could stimulate further economic expansion.

Lift—enhance productivity across all sectors. Boosting overall economic productivity is required to drive higher returns, especially in the face of a shrinking workforce.

With the right framework conditions, the "shift and lift" strategy could enhance return prospects for investors, thereby mobilizing the capital needed for a pivot to growth. This would benefit all stakeholders. If Germany maximizes its potential (the full-potential scenario), the value of economic activity could reach approximately €24.5 trillion by 2035 (Exhibit 1). This represents roughly four times the current market capitalization of the 230 companies listed on the DAX, MDAX, TecDax, and SDAX. In this scenario, average household income would rise from the current €72,000 to around €100,000 annually by 2035.

Shift: Focusing on dynamic sectors

To unlock new growth opportunities for the German economy, a strategic shift in the economic portfolio toward more dynamic sectors is imperative. The selection of these sectors can be guided by two key criteria: their global growth dynamics and their alignment with the strengths and domestic demand of the German economy. Below, we present three promising future-oriented sectors that are well suited to Germany's conditions (though this list is not exhaustive or definitive).

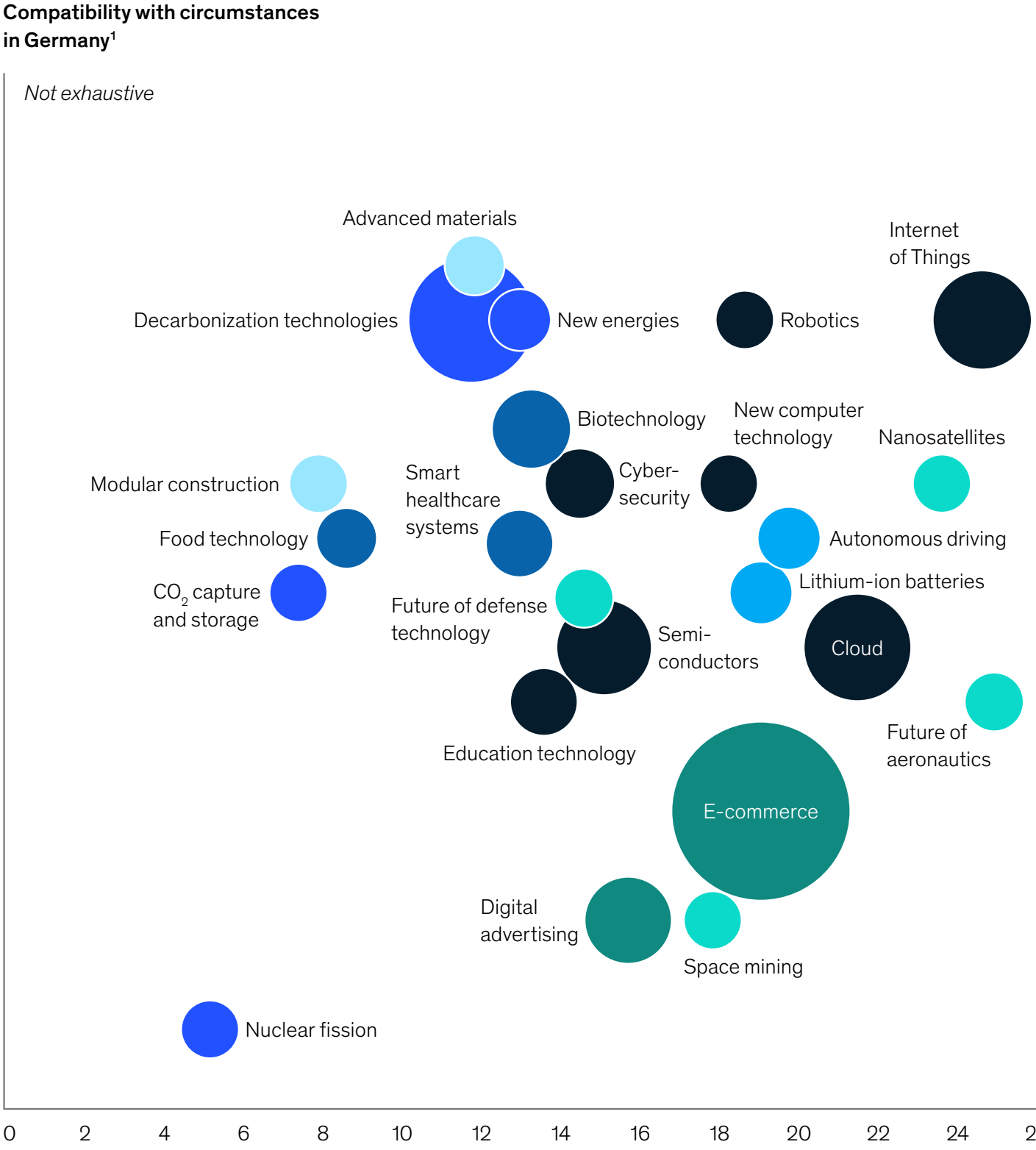
— **Healthcare.** With Germany's aging population and an investment backlog of around €30 billion in its hospitals alone,[29] the country faces a significant challenge in ensuring affordable healthcare. This situation, however, also presents a unique opportunity for the German economy, which is renowned for its strengths in medical technology, biotechnology, and robotics. By harnessing digitization, AI, and existing health data, Germany could position itself as a global leader in healthcare innovation. For example, robots developed and manufactured in Germany could significantly alleviate the workload of healthcare professionals. Such technologies are in high demand globally; projections indicate that the market for humanoid robots could grow by 17 percent annually from 2024 to 2031.[30]

— **Battery technology.** Currently, Germany plays only a minor role in the production of the lithium-ion batteries that prevail today. This market is dominated by China, Japan, and South Korea. Attempting to catch up in this area would be costly and unlikely to succeed due to Germany's high cost levels. However, the outlook is more promising for high-performance, sustainable alternatives to lithium-ion technology. McKinsey analyses suggest significant economic and technological growth potential for next-generation batteries, with a potential compound annual market growth rate of 40 percent through 2035.[31] Germany could leverage its strengths in research and development to secure a lead in technologies such as solid-state, silicon-anode, sodium-ion, or lithium-sulfate batteries based on early engagement ("leapfrogging"). Initiatives like the NextGenBatt and FestBatt clusters—which bring together academia and industry—are already in place.[32]

— **New materials.** Germany is home to many highly specialized and interdisciplinary companies focused on the research, development, and production of innovative materials.[33] The market for such materials offers numerous growth opportunities, including bioplastics, recyclable composites, and low-emission building materials. These materials have the potential to reduce both environmental pollution and dependence on limited resources. Additional growth areas include high-performance alloys, nanomaterials, and 3D printing. These technologies enable the production of lighter and more stable components while simplifying and accelerating production processes. Germany already provides public funding for material science projects with high application potential.[34] By focusing more strongly on innovation in new materials, Germany has the opportunity to establish itself as a technology leader in rapidly growing fields.

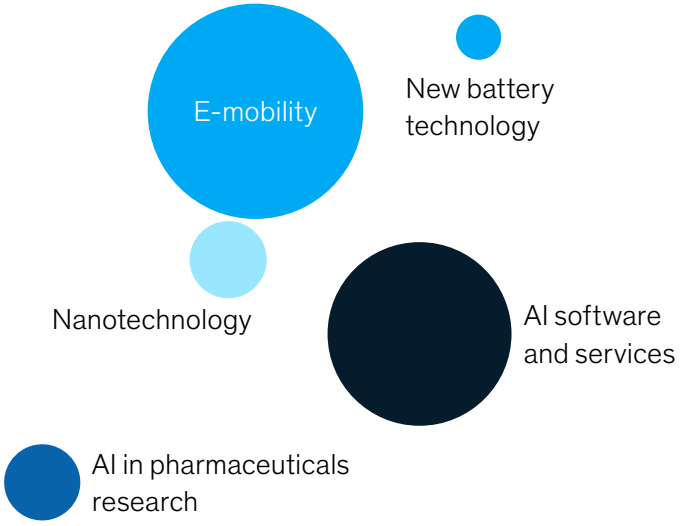
Exhibit 5

Possible future-oriented areas for Germany



1 Expert assessments based on current significance and expected future demand

Source: Data Bridge Research; Fortune Business Insights; Grand View Research; expert assessments



Global market volume, 2035

- Digitization and AI in industry
- Automotive and electromobility
- Sustainable energy and decarbonization
- Advanced manufacturing and materials
- Biotechnology and health
- Aerospace and defense
- E-commerce and digital economy

28 30 32 34 36 38 40

Global growth dynamics,
compound annual growth rate,
2024–35, percent

To capture the full potential of dynamic sectors, leading companies continually review and adjust their portfolio as needed. They pressure-test established practices and, when necessary, phase them out while ensuring higher-value substitutes. This approach applies not only to industries, technologies, and business models but also to skills and ways of working.[35] The German economy as a whole could benefit from adopting similar strategies. Achieving a pivot to growth requires Germany to shift away from low-growth sectors and toward dynamic sectors. This could be accomplished by adjusting the activities of existing companies and increasing the number of start-ups in these dynamic sectors.

The sectors listed above are merely examples. Growth opportunities exist across various domains—such as in finance, agriculture, and the chemicals industry. Resilient companies continually reinvent themselves, embracing self-disruption and creative destruction. They seek growth opportunities in their market environment based on their strengths.[36] According to our analyses, key success factors include flexible resource allocation, a clear focus on innovation, and the willingness to form new partnerships.

— **Flexible resource allocation.** Many of the fastest-growing and most profitable companies deploy their capital, talent, and capabilities dynamically. They respond quickly and decisively to new opportunities. A McKinsey study shows that companies that reallocate their investments according to need and develop new business areas significantly improve their earnings potential.[37] An as-yet unpublished McKinsey analysis indicates that industrial companies successfully integrating software products into their portfolios achieve double-digit increases in revenue growth. A central aspect of resource allocation, besides growth dynamics, is the margin strength of the respective business areas. In segments focused on high-quality goods and services, high margins can be achieved. The Swiss economic model provides an instructive example. Switzerland has always had a strong portfolio of high-quality industries. In recent years, it has further diversified this portfolio and strengthened its position in high-quality pharmaceutical products. This sector has significantly contributed to Switzerland's overall economic growth over the past 20 years based on strong growth and high margins.[38]

— **Focus on innovation.** High-growth companies outpace their competitors by investing more in research and development for new products, processes, and services. They consistently prioritize delivering high customer value and are not afraid to make fundamental changes to their value proposition when necessary. These companies attract top-tier researchers and developers, and they actively pursue new technologies. They cultivate a culture of creativity and risk-taking by fostering open communication and the exchange of ideas. Continuous testing and iteration ensure rapid cycles from development to commercialization. According to a McKinsey survey, innovation-focused companies are three times as likely as other companies to encourage their employees to experiment. They embed iterative processes throughout the organization and leverage technology and analytics to accelerate testing, prototyping, and the commercialization of innovations. Successful innovators employ digital tools, including AI, twice as often as their competitors. This focus on innovation yields significant benefits, increasing the likelihood of achieving technological leadership in novel products—and thus driving more growth and higher margins than in existing businesses.[39]

— **Willingness to form new partnerships.** High-growth companies strategically expand their portfolios through acquisitions or joint ventures, divest low-growth areas, and establish an ecosystem of partners ranging from start-ups and universities to suppliers, logistics partners, and customers. Companies that do not rely solely on organic growth but strategically expand their portfolios through mergers and acquisitions tend to outperform their competitors. According to a McKinsey analysis, companies that expand their portfolios into high-growth areas through targeted acquisitions achieve an increase in total shareholder returns of more than 6 percent.[40] Engaging in strategic partnerships and building an ecosystem of partners can also be highly beneficial. A recent McKinsey study shows that companies actively collaborating with start-ups can boost their innovation potential by 30 percent. Such partnerships are not merely about sharing resources; they also involve leveraging the agility and innovative ideas of start-ups to enhance a company's competitive edge.[41]

However, changes within established companies alone will likely not suffice to double the value of economic activity in Germany. An increase in start-up formation beyond current levels is also crucial, given that start-ups are key innovation drivers that can generate substantial and rapidly growing value. While Germany has made notable strides in this area in the past, recent years have seen a backlash: in 2021, 2,900 start-ups were founded in Germany, but this number declined to 2,500 by 2023. In contrast, the United States sees nearly ten times as many start-ups, although the US population is only about four times that of Germany.[42] Moreover, German start-ups face a lower likelihood of securing additional financing rounds as their capital needs increase, compared with their US counterparts. Enhancing access to financial resources in later funding stages could significantly improve the conditions for start-up success in Germany.[43]

Lift: Boosting productivity

While “shift” concentrates on redirecting resources and investments toward dynamic growth areas, “lift” aims to elevate productivity across all sectors and value chains. There is substantial room for improvement, since Germany currently trails leading countries in productivity. Its GDP per hour is approximately 30 percent lower than that of leading European countries and the United States.[44] Furthermore, the number of employable individuals in Germany is expected to decrease by three million by 2035.[45]

Companies aiming to enhance their productivity can focus on several critical areas, including digitization, lifelong learning, lean processes, optimized supply chains, scaling, and operational excellence.

— **Digitization, automation, and AI.** Companies at the vanguard of comprehensive digitization, automation, and AI implementation significantly boost their productivity by reducing manual tasks, enhancing the accuracy of workflows, and optimizing decision-making processes. Analyses show that these companies achieve a 30 to 40 percent increase in productivity compared with their competitors.[46] Successful companies identify high-potential applications with lighthouse potential, where they can pilot and showcase the implementation of new technologies.[47] A holistic approach is helpful to unlock value potential across units and locations.[48] Often, organizational and management adjustments are necessary to align with new, technology-based processes.[49] Additionally, leading companies adapt their risk management strategies to address the specific risks associated with new technologies, such as those related to generative AI, ensuring the responsible use of innovative solutions.[50]

Germany’s GDP per hour is ~30% lower than that of leading European countries and the US.

— **Lifelong learning.** Productive companies systematically identify the new skills and knowledge essential for maintaining and expanding their competitiveness. Based on this, they invest in targeted upskilling and reskilling for their workforce. A study by the McKinsey Global Institute indicates that technical and analytical skills are becoming increasingly vital for the competitiveness and productivity of companies.[51]

— **Lean processes.** Productive companies analyze, improve, and streamline their business processes to ensure seamless and cost-efficient operations through complete transparency, integration, and synchronization. According to an unpublished McKinsey analysis, industry-leading organizations that adopt lean processes achieve 20 to 40 percent higher labor productivity than their competitors.

— **Optimized supply chains.** Productive companies leverage deep analytics and holistic approaches to plan, manage, and optimize their supply chains. A McKinsey survey reveals that companies that are successful in optimizing their supply chains employ advanced planning systems with integrated risk management. These systems enhance the resilience, efficiency, and customer focus of their supply chains.[52]

— **Greater company scale.** Mergers and acquisitions boost company productivity by creating synergies. In Germany, only one in ten companies grows into a large enterprise, compared with one in four in the United States and Israel.[53]

— **Culture of operational excellence.** Highly productive companies do not rely on isolated actions to increase productivity. They foster a culture of operational excellence across all areas. They utilize continuous improvement, shared objectives, lean management, and agile work methods to achieve maximum productivity. Companies that implement a culture of operational excellence can increase their labor productivity by up to 30 percent compared with their competitors.[54]

In addition to the approaches mentioned above, the renewal of the economic portfolio (shift) through a stronger focus on innovative technologies, dynamic sectors, and novel business models can also contribute to increased productivity. This is demonstrated by a study by the McKinsey Global Institute on the strategies of particularly productive companies.[55]

Another potential approach to boosting value creation in Germany is increasing the number of working hours per capita. The average is around 1,800 hours in the United States, around 1,730 hours in Italy, and around 1,520 hours in the United Kingdom. Germans, in contrast, work an average of only around 1,350 hours per year.[56] Reasons for this significant gap include the high share of part-time employment and the prevalence of marginal employment (mini-jobs) in Germany. Increasing the number of working hours per capita could help enhance the growth dynamics of the German economy (see also “Increased labor market flexibility” in the following chapter).

Our CxO survey

In the summer of 2024, we conducted a survey of over 130 CxOs from companies operating in Germany, covering a wide range of sectors and company sizes.[57]

According to the surveyed CxOs, significant changes are necessary to foster greater growth in Germany. The responses also offer valuable insights into the most important factors for increased investment and potential actions to accelerate the renewal of the German economy from the perspective of German CxOs.

Germany is a crucial location for the companies of the surveyed CxOs, both as a production location and as a sales market.

— Of the companies surveyed, 42 percent generate more than half of their revenue in Germany. In addition, 60 percent report that Germany accounts for more than half their share of production.

— In terms of outlook, 33 percent of respondents expect their company's footprint in Germany to grow over the next five years. The other two-thirds anticipate stagnation (35 percent) or decline (32 percent). Notably, companies in the manufacturing sector are more likely to plan a reduction of their footprint in Germany (47 percent), compared with only 23 percent in the service sector.

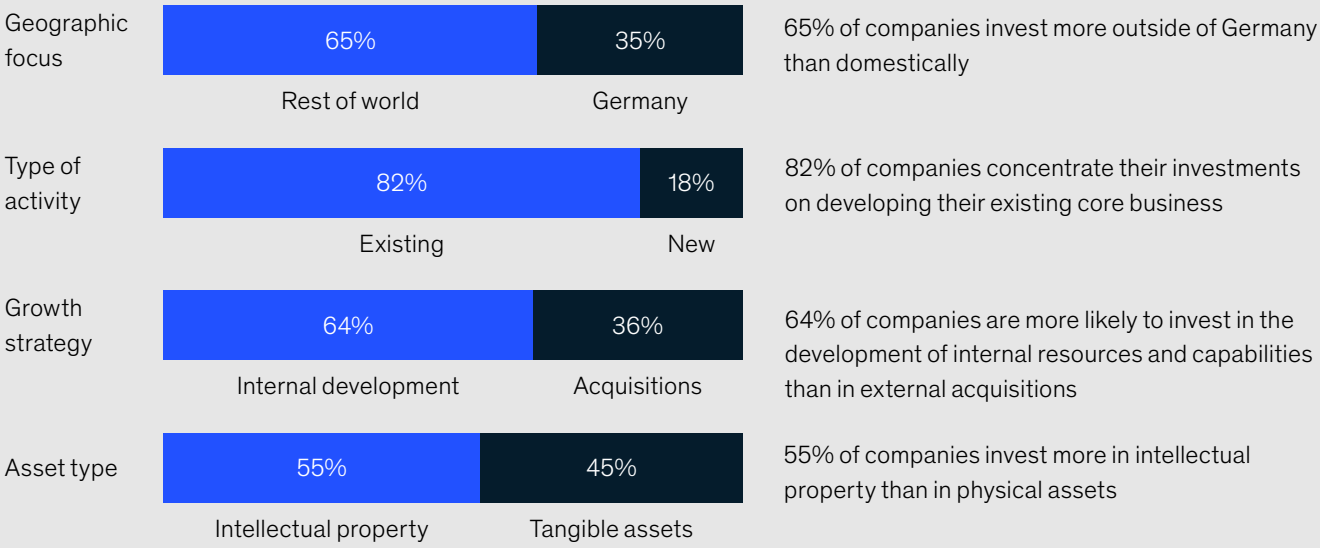
— This trend is also evident in current investment activity (Exhibit 6). Presently, 65 percent of the companies in our sample invest more abroad than in Germany, with large companies (revenues exceeding €10 billion) being particularly likely to invest more abroad (83 percent).

What conditions would encourage more investment in Germany? The surveyed CxOs identify a high need for action in the areas of the labor market, demand development, and energy costs. Additional factors mentioned include uniform, business-friendly regulation across the European Union and an EU-wide budget for precommercial innovation procurement (Exhibit 7). The survey also gave CxOs the opportunity to suggest further conditions that would increase investment. The

Exhibit 6

Investment focus of German companies

Allocation of investments



Source: McKinsey CxO Survey, "Accelerating Germany," September 8, 2024

majority of these entries emphasized the need for deregulation and reducing bureaucracy. One comment reads, “More entrepreneurial freedom and less regulation in all areas.” Another states, “More stable regulation and framework conditions.”

The surveyed CxOs express a clear sentiment that insufficient action is being taken to stimulate growth in Germany. A significant majority, 84 percent, acknowledge that while the issue is understood, the implementation of action lacks urgency (“no sense of urgency”) or is insufficient (“very little action taken”). Furthermore, 15 percent believe that the solutions implemented thus far are not effective. Only a marginal number of respondents (about 2 percent) are optimistic that the transformation of the German economy is on track and will deliver results within the next two years. When queried about the most critical levers to accelerate the transformation, respondents highlighted the following areas:

— Processes in public administration (77 percent)

— Vision, narrative, and mindset (64 percent)

— Regulatory and economic stability (63 percent)

Additional acceleration levers mentioned include improvements in public infrastructure, enhanced collaboration between public and private actors, and a focus on education and lifelong learning.

Exhibit 7

Prerequisites for more investment in Germany

Which factors would increase your company’s investments in Germany most and/or contribute to expanding your presence in Germany?

Talent	Increased “flexicurity” and simplified labor market regulations
Macro-environment	Strong and stable demand outlook (e.g., based on fiscal incentives)
Energy	Natural gas and electricity prices in line with those in the US and China (around half of current prices)
Integrated EU single market	A 28th regime of the EU with uniform and corporate-friendly labor, tax, and product regulations
Innovation	A comprehensive EU budget of around €100 bn for “precommercial innovation procurement”
Industrial policy	Support comparable to the Inflation Reduction Act in the US
Trade and supply chains	Long-term access to key materials
Competition policy	Simplified consolidation processes
Capital	Capital markets union along with deepening of the private equity and venture capital markets

Source: McKinsey CxO Survey, “Accelerating Germany,” September 8, 2024

Priorities for implementation

To maximize the benefits of the dual shift and lift strategy for the country and its people, Germany could more effectively align conditions for investors and businesses with growth objectives. According to German CxOs, the top priority is enhancing labor market flexibility to enable more investment. We hope the insights presented in this chapter will inspire a balanced approach between stability and dynamism in key areas. The ultimate objective: to drive more growth for everyone in Germany through increased willingness to embrace change.

A flexible labor market allows companies to fill open positions quickly

Targeted support helps developers of mini-robots attain market leadership

The texts in this exhibit illustrate potential outcomes of adjusting the framework conditions in Germany. These examples are not exhaustive and they do not constitute recommendations.

Shift-related priorities

To foster a stronger focus on dynamic sectors—both within existing companies and based on new ventures—four critical areas need attention: targeted support for technological innovation, increased labor market flexibility, mobilization of capital for investment in growth, and streamlined public administration.

CxOs identified increased innovation funding as one of the top 5 conditions for boosting investment in Germany.

Targeted support for technological innovation

Most dynamic sectors rely on technological innovation. This is why sustainable economic growth without technological leadership is next to impossible. However, Germany lags behind in many future technologies. One reason is that support for technological innovations is dispersed across various sectors and managed by multiple institutions, making it challenging to set overarching priorities.[58] The CxOs we surveyed identified increased innovation funding in the precommercial stage as one of the top five conditions for boosting investment in Germany.

One potential solution: Germany could strive for a leading role in technologies such as deep tech (e.g., humanoid robots, quantum computers, nanosatellites) through targeted support and a regulatory environment that promotes innovation. Additionally, fostering competition for innovation investments with predictable financial outlooks could enhance technological leadership. Germany could look to countries like the United States, where NASA collaborates with private-sector partners to advance space research.[59] Moreover, the United States has designated 31 communities as regional innovation and technology hubs to bolster competitiveness in areas such as semiconductor production and AI. These hubs unite various stakeholders, including universities, private companies, local governments, and unions.[60] The United States also supports innovation with regulation. Austin and San Francisco, for instance, permit autonomous vehicle testing on public roads. San Francisco collaborates closely with operators of autonomous vehicle fleets to facilitate testing, thereby significantly accelerating innovation.[61]

Europe also offers examples of targeted support for technological innovation, such as the Chips Act aimed at addressing the semiconductor shortage. The European Union is mobilizing €43 billion from public and private sources for three key initiatives: to build technological capacity and drive innovation, to promote public and private investments in production facilities, and to coordinate efforts through the European Semiconductor Board.[62]

According to CxOs, a more flexible labor market is the most important prerequisite for increased investment in Germany.

Increased labor market flexibility

To unlock new business opportunities, well-trained specialists are essential, both among the current workforce and future employees. However, the number of job vacancies in Germany has risen by nearly 70 percent over the past decade, while the employable population is declining. This has led to a shortage of skilled workers, particularly in the most productive and fastest-growing sectors of the German economy. According to the CxOs who participated in our survey, a more flexible labor market (increased “flexicurity” and simplified labor market regulations) is the most important prerequisite for increased investment in Germany.

Germany could address this challenge by seeking a new balance between job security for employees and flexibility for companies, encouraging more workers to transition into growth-oriented professions. Additionally, expanded qualification and retraining programs could help meet the evolving demands of the labor market; unemployed individuals could reenter the workforce more quickly with enhanced qualifications. Denmark's flexicurity model serves as an exemplary approach, balancing employer flexibility with employee security. The barriers to hiring new people and laying off employees are relatively low, reducing costs and avoiding legal disputes. Employees who are members of an unemployment insurance program receive support for up to two years if they lose their jobs. Moreover, the Danish government provides extensive support with its education and retraining programs along with counseling services to help the unemployed reenter the labor market quickly.[63]

Furthermore, Germany could aim to increase the number of employable individuals who are in employment. France and Sweden offer successful examples of how this can be achieved. In these countries, childcare is better aligned with the needs and working hours of employed parents.[64] The result: in France, average annual working time is about 12 percent higher than in Germany; in Sweden, the lead is 7 percent.[65] In these comparison countries, more employees work full time, and those who work part time work more hours per capita, partly due to better childcare options.

To ensure a sufficient supply of qualified workers for Germany's economic transformation, those entering the country from abroad could be integrated into the labor market more swiftly. The Netherlands offers a leading example with its Civic Integration Program, which combines language courses with internships or volunteer work.[66] Additionally, Germany could enhance its attractiveness to highly qualified professionals by establishing a fast track to residence permits for individuals with advanced education, relevant work experience, and specialized knowledge in areas vital to domestic economic growth.

Looking ahead, continuous skill development and qualification could become an integral part of working life. Each individual could be encouraged to take greater responsibility for their professional growth. Singapore's SkillsFuture program exemplifies this approach, providing employed individuals with a personal training budget and access to more than 7,000 courses.[67] Further proposals for labor market flexibilization and activation have been developed by the Alliance of Opportunities.[68] McKinsey Germany is a knowledge partner of this alliance.

By 2035, investments totaling ~€680 billion will be needed for research and development alone.

Mobilization of capital for investment in growth

Substantial capital investment is required to better align the German economy with dynamic future fields. By 2035, investments totaling approximately €680 billion will be needed for research and development in promising areas alone (full-potential scenario). While Germany has ample capital in principle, a significant portion of it is not currently available for growth-relevant investments. Moreover, high-risk areas such as large infrastructure projects and new technology development often receive no private funding at all.

Germany could significantly boost public spending on investments. Countries like New Zealand already facilitate this with double-entry bookkeeping in their budgets. By transitioning from cameral accounting, which Germany currently uses for public spending, to double-entry bookkeeping, investments could be depreciated over several years. This would make investments more manageable, since the full amount would not impact the budget all at once.[69]

Germany could more strategically direct its existing capital toward domestic growth and risk investments, following the example set by France's Tibi Initiative for tech financing.[70] The United States has found a way to activate capital more effectively, with venture capital investments as a percentage of GDP being more than eight times higher than in Germany, primarily driven by pension funds.[71] In the United States, pension funds contribute 20 percent of the capital in venture capital funds, compared to a mere 8 percent in Germany.[72] Consolidating German pension reserves could enable larger-scale investments with improved risk-return profiles. And increased investment in venture capital and private equity by German pension funds could yield higher returns and better portfolio diversification, while also funneling more capital into innovative sectors. This strategy is already widely practiced in Australia.[73] Additionally, adjusting the Solvency II regulation could unlock more capital for growth.[74]

The German government is taking first steps to address these challenges with its WIN Initiative, collaborating with powerful investors to bolster Germany's innovation ecosystem. The initiative aims to mobilize over €10 billion for investments in high-growth start-ups and enhance conditions for venture capital providers.[75]

77% of the CxOs in our survey call for an acceleration of public administrative processes.

Streamlined public administration

Public administration plays a pivotal role in either impeding or accelerating economic growth. In our survey, CxOs emphasize the need to expedite public administrative processes, with 77 percent of respondents identifying this as a critical factor in rapidly revitalizing the German economy.

Germany has the opportunity to streamline its public administration to support economic renewal. Permit applications, for example, could be processed far more efficiently and swiftly than they are today. In the Netherlands, the approval of applications for heavy transport permits is granted in less than a week on average, where it currently takes six to 12 weeks in Germany.[76] This efficiency is achieved through centralization and complete digitization. Vehicles are registered online, and the planned route and vehicle dimensions are submitted digitally. The entire process is handled by the Dutch Vehicle Authority, which can issue permits without involving additional agencies. Portugal is also innovating in this area, where permits are automatically granted if the public administration does not process the application within a legally stipulated period.[77]

In the future, Germany could prioritize user-friendliness in administrative processes. In South Korea, for example, citizens can access a wide range of public services with a single ID, eliminating the need for repeated form submissions and reducing the number of visits to government offices.[78]

Further insights into the digitization of public administration can be found in the McKinsey article “Digital public services: How to achieve fast transformation at scale.”[79]

Lift-related priorities

To achieve the productivity increase targeted by the dual strategy in Germany, four key areas are crucial: accelerated AI implementation at scale, future-proof energy supply at competitive prices, utilization of the EU internal market for scale, and strengthened and stabilized demand.

Tasks taking up 60 to 70% of employees' time in public administration could be automated.

Accelerated AI implementation at scale

The digitization of the German economy, particularly the implementation of AI, offers significant potential to increase productivity and enhance the country's attractiveness as a business location. According to a McKinsey study, AI has the potential to substantially boost labor productivity in Germany by 2040.[80]

By placing a stronger emphasis on digitization and AI, Germany could significantly streamline various processes, particularly in public administration. A recent McKinsey analysis indicated that the use of generative AI and other technologies could automate tasks that currently take up about 60 to 70 percent of employees' time in public administration. These tasks include content creation and synthesis, as well as interactions with citizens.[81]

Moreover, AI can contribute to making administrative processes fairer and more transparent. For instance, if AI were employed to evaluate applications based on uniform criteria, all applicants could be assured of equal treatment under the same conditions, irrespective of the applicant or the specific caseworker involved. In the United States, this approach—specifically using AI-based natural language processing—has expedited the processing of social benefit applications, making it more reliable and more efficient than traditional methods.[82]

Small businesses stand to gain significantly from the implementation of digitization, automation, and AI. Singapore, for example, supports small and medium-size enterprises by promoting AI adoption with grants that cover the costs of acquiring AI licenses and running training programs. This initiative lowers the barrier for businesses to implement AI and boosts productivity.[83]

In the education sector, AI could facilitate more effective and personalized learning. South Korea offers AI training for teachers and encourages the use of AI in classrooms, which has demonstrably improved overall learning outcomes and prepares students for the effective use of AI in other contexts.[84]

Success factors of implementing digitization, automation, and AI include the expansion of existing technical infrastructure, systematic development of technical skills, effective risk management, complete transparency, and societal acceptance.[85]

CxOs rank affordable energy among the top 3 conditions for increased investment in Germany.

Future-proof energy supply at competitive prices

A secure supply of energy at internationally competitive prices is essential for a strong, productive, and resilient economy. According to the CxOs of German companies we surveyed, affordable energy is one of the three most important conditions for increased investment in Germany.

Germany has the potential to secure a future-proof and competitive energy supply by advancing its energy transition strategy. This development could reduce the system costs for transforming the German energy system by up to 20 percent (€150 billion). Key elements of this approach include constructing more modern gas power plants capable of running on hydrogen in strategic locations and aligning the expansion of wind and photovoltaic capacities more closely with demand. This strategy would necessitate less extensive grid expansion compared with current plans. Additionally, it would enable Germany to meet rising electricity demand during winter months and peak load times entirely with domestic generation capacity. This would achieve the emission reduction targets set by policymakers for 2035 (a 90 percent reduction compared with today) while enhancing supply security and the economic viability of the energy transition. Furthermore, it would address challenges such as rising grid fees and regional bottlenecks.

Moreover, Germany could bolster the future viability of its energy system by fostering entrepreneurial activity and having scientists focus on innovative energy sources and storage solutions. These and other proposals for ensuring a secure energy supply at competitive prices are detailed in the McKinsey study "Zukunftspfad Stromversorgung" (Pathway to the future of power supply), published in January 2024.[86]

CxOs identified uniform regulations across Europe as one of the top 5 conditions for increased investment in Germany.

Utilization of the EU internal market for scale

With approximately 450 million citizens, the European Union is the world's largest multinational internal market. At around $17 trillion, the European Union's GDP is comparable to that of the United States.[87] In our survey, CxOs identified uniform, business-friendly regulations across Europe as one of the five most important conditions for increased investment in Germany.

A study by the McKinsey Global Institute indicated that to keep pace with their US competitors, European corporations would need to nearly double their current size while adhering to antitrust regulations, for example through international expansion.[88] Currently, however, the partly inconsistent regulation across EU member states is perceived as a major obstacle to scaling business models and companies in Europe.[89] From a business perspective, the integration of the EU internal market is only three-quarters complete.[90] Experts estimate that the current restrictions are reducing the European Union's GDP by 5 to 10 percent.[91]

A possible approach to advance the integration of the EU internal market is the introduction of the "28th regime." This regime would feature simplified, EU-wide regulations, giving companies the option to adhere to this regime or to the legislation of individual member states. This kind of legal framework could cover areas such as product liability, labor protection, professional qualifications, taxation, and competition. The 28th regime would make it easier for companies to pursue cross-border contracts, mergers, and acquisitions, thereby lowering the threshold to achieve an internationally competitive scale.[92]

In addition, barriers to the free flow of capital within the European Union could be further lowered. This could include areas such as insolvency law, financial market supervision, and deposit insurance. Lowering barriers in these areas would enable national markets to become more closely interlinked, providing companies with easier access to financial resources, enhancing financial stability, and facilitating the development and implementation of financial innovations. According to a McKinsey study, more integrated capital markets could foster prosperity in Germany and contribute to an increase in international competitiveness.[93]

A comparison of the European Economic Area with the United States and China, along with suggestions for enhancing the competitiveness of the European economy, can be found in the McKinsey Global Institute article "Accelerating Europe: Competitiveness for a new era.[94]

CxOs rank strong and stable demand as the second most important condition for increased investment in Germany.

Strengthened and stabilized demand

To double the value of economic activity in Germany, robust demand for domestic goods and services is crucial. After all, three-quarters of Germany's GDP is driven by consumption.[95] In our survey, CxOs identified strong and stable demand as the second most important condition for increased investment in Germany.

Germany could implement various actions to create the conditions for stable demand, thus providing a reliable foundation for entrepreneurial decisions. Adjustments to the tax and social security burden on labor income, for instance, could be considered to stabilize consumer spending despite the population decline in the age group that drives the bulk of consumption.[96] In Germany, the average tax and social security burden on labor income is 48 percent; the OECD average is only around 35 percent (2021).[97]

A predictable retirement income could help ensure that employees do not have to put money aside out of fear of old-age poverty, which would increase leeway for higher consumer spending. A reform of the pension system should also be considered, since maintaining the current structures could lead to a declining level of security for statutory pensions with sharply rising contribution rates.[98] Sweden offers a possible solution: there, the retirement age is linked to life expectancy in the long term.[99] As average life expectancy increases, the retirement age automatically moves up.

* * *

Each initiative outlined in this chapter holds the promise of bolstering the German economy and pivoting to growth. However, these individual approaches would have the most impact if executed in a coordinated and harmonized manner, particularly for the development of specific future-oriented fields. The success of the coordinated approach to securing gas supply during the winter of 2022/23 serves as a prime example.[100]

Moving forward together

For the growth pivot to succeed, a shift in mindset is crucial: less “Yes, but…” and more “Why not?” Less “This will never work” and more “What do we need to make it happen?” Less “Count me out” and more “I’m in!” This sentiment is echoed by Germany’s CxOs, 64 percent of whom believe that a shared vision and an openness to change would expedite the renewal of the German economy. The key word here is “shared.” If Germany achieves a pivot to growth, everyone stands to benefit, and to make it happen, everyone can contribute: political decision-makers, companies, investors, banks, scientists, researchers, and citizens.

— **Political decision-makers** can champion the dual strategy of shift and lift by spearheading strategy development, program design, implementation planning, and communication, while working closely with the private sector and academia.

— **The private sector** can lead the way in tackling significant future-oriented tasks by pooling resources. For example, consortia can address challenges that surpass the capabilities of individual companies.

— **Investors and banks** can catalyze transformation by creating innovative financial products with low initial investments, extended terms, and flexible repayment structures.

— **Scientists and researchers** can propel the future resilience of the German economy by engaging in more applied research, pursuing stronger industry collaboration, and fostering entrepreneurship.

— **All citizens** can play a role in driving the pivot to growth based on their mindsets and actions, such as embracing job changes and committing to lifelong learning.

Growth starts with recognizing that standing still is not an option, and it is driven by everyone's resolve to be part of the solution by embracing change. Each stride toward executing the dual strategy for greater growth can help put Germany on an upward trajectory. As investment returns improve through pioneering entrepreneurial decisions favoring dynamic sectors and heightened productivity, more capital is unlocked. This fuels further economic activity, boosts wages, and increases tax revenues. The amplified economic activity leads to higher earnings and higher company valuations based on current and anticipated profits. Rising earnings pave the way for further investments, setting off a virtuous cycle of higher returns, increased investments, and robust growth (Exhibit 8). This could help make the vision of growth for all a tangible reality. All it needs is someone to get the ball rolling.

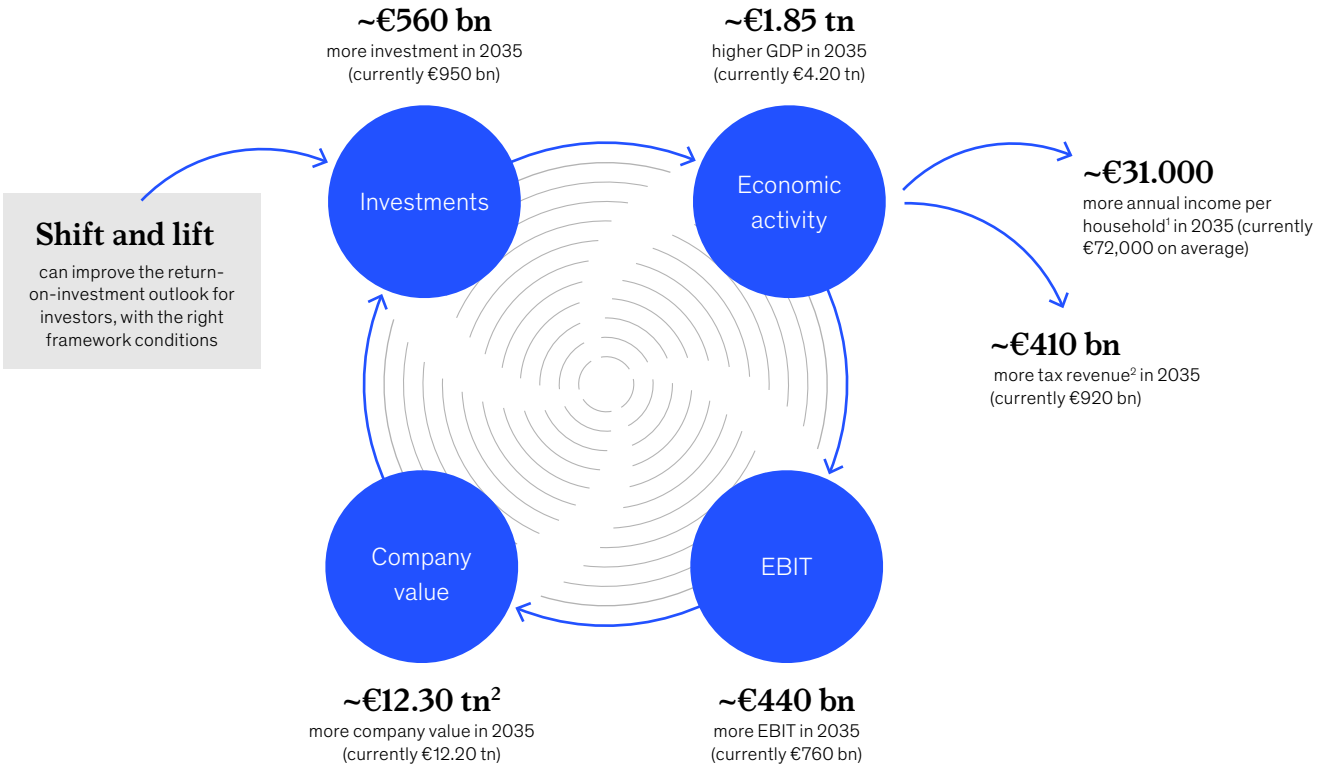
About this study

McKinsey undertook this study independently, without external commissions or remuneration.

Exhibit 8

Potential virtuous cycle for the German economy

Averages in 2023 prices



1 Assumption: at 2023 pay ratio and household size
2 Assumption: at 2023 tax rates

Source: OECD; German Federal Statistical Office; McKinsey analysis

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