The Stern Stewart Institute

BRAVE NEW WORLD

PERIODICAL #23

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BRAVE NEW WORLD

We need a brave new world – in a very literal sense. Brave is by definition "showing no fear of dangerous or difficult decisions" – so yes, that's what we need.

Today's reality is rather contrary to this. The first victim of COVID was differentiation. Black and white were the colors of the day. The current victim of the climate discussion is the total economy. As if "no alternative" is the only political raison d'être.

Germany is an industrial nation. The land of engineers and innovators. We need energy. Clean energy. Renewables alone cannot or will not feed the growing energy hunger. And CO_2 pricing alone will not save the climate.

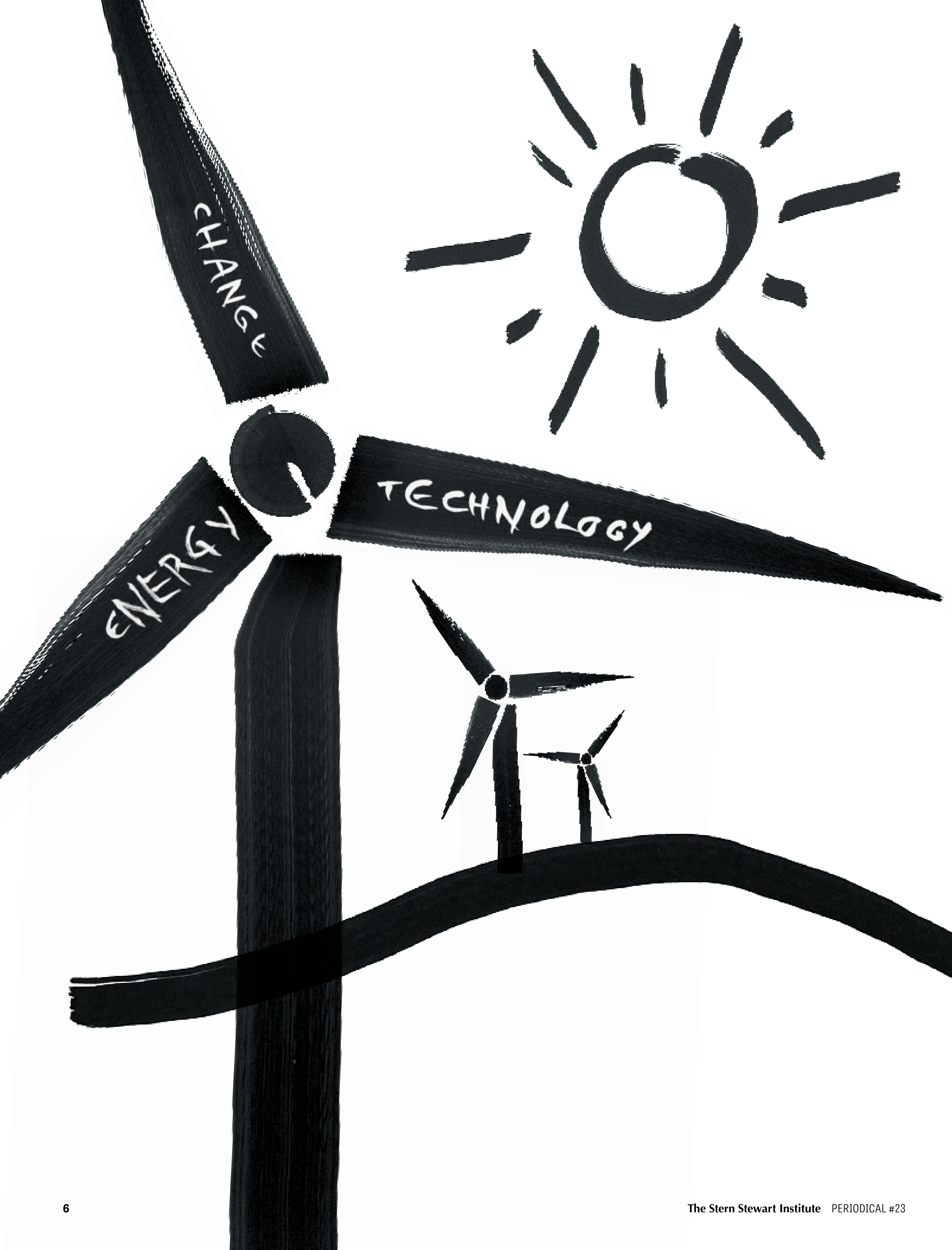
We need brave new ideas. Green hydrogen is one. But where will the required green electricity come from? If nuclear is not an option, then we need, as a matter of urgency, to have a technologically open discussion on the future of our energy supply, rather than blaming the economy and falling into a prohibition mode.

So, let's join forces and create a brave new world! Our authors are already showing the way. Their pieces in this 23rd periodical lay out their own different, brave steps towards a new world, in fields ranging from energy to business to politics.

Enjoy the read!

Yours,

Gerhard Nenning
Executive Director of The Stern Stewart Institute



Dr. Christian Bruch
Siemens Energy

A New Geopolitical Energy World

The world is facing the major challenge of guaranteeing a sustainable energy supply while meeting climate targets.

Dr. Christian Bruch A New Geopolitical Energy World

The world faces a major challenge to guarantee a sustainable energy supply that meets the enormous and ever-increasing demand for energy to support economic development and ensure the stability of societies. At the same time, the increasing pace of climate change is pushing us to meet these needs more sustainably with the clear goal of achieving carbon neutrality. Studies forecast a nearly 50% increase in global energy demand by 2050, especially in regions like Asia where strong economic growth is driving demand. With increasing electrification of processes, e.g. through battery electric vehicles in the mobility sector, electricity demand will grow even stronger. In industrialized countries like Germany, a tripling of the electricity demand over the next two to three decades is even possible. Alongside the energy transformation also the global tectonics are likely to change. The shift from fossil fuels to renewables will change the relevance of countries currently supplying coal, gas and oil to the global market and increase the importance of regions with a cost competitive access to renewable energy.

Signs of a course change in today's political action

More and more countries and economic regions are setting ambitious climate targets. An important milestone was the historic 2015 Paris Climate Agreement, which aims to hold the increase in the global average temperature to well below 2 °C above pre-industrial levels and to pursue efforts to limit the rise to 1.5 °C. Since then, almost 70 countries have committed to net-zero emissions. The U.S. has rejoined the Paris Climate Agreement and wants to switch its power supply completely to clean energies by 2035. Ambitious goals such as Germany's coal phase-out and the renewed targets with climate neutrality by 2045, the EU's 2050 target, and China's commitment to become climate neutral before 2060 are further examples of this change in direction. And it is to be expected that the participants of the UN Climate Change Conference – COP26 – will decide on further measures. However, the most important lever for the success of the resolutions is the social acceptance for change. If we want to meet the Paris climate targets, we need to make drastic changes to our behavior both as a society and as individuals. The biggest hurdle to the success of the energy transition today is most likely the social acceptance of change. We cannot simply carry on as we are and still believe that we will be climate neutral by 2050 at the latest. Change may hurt, and it will impact every single one of us. We will no longer be able to accommodate all sensitivities, however understandable they may be, and we will have to restrict ourselves in some areas, give up comforts. This is a truth that we must face.

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Pandemic has reinforced our national reflexes

The transformation of our global energy systems will be a journey. A journey that has the goal of building a sustainable world for everyone. Furthermore, different regions around the world are starting from different points and are at different stages in their development. This is why we will need a variety of solutions to take the next steps towards the goal of a "sustainable world". Companies with their technological expertise, global positioning and local roots can and must be important drivers here. To meet the energy challenge ahead, governments in particular must also set priorities and create a framework that attracts massive private capital. In the next twenty years, we will have to invest approx. 40,000 billion dollars worldwide in energy, in infrastructure, in the transition to renewable energy and in energy efficiency – a colossal undertaking. The covid19-pandemic has painfully shown us what we have been missing. We knew that a pandemic was possible, and we were not adequately prepared to face it. The crisis of climate change is also before our eyes, and that should spur us to action. But it is unfortunate that the current pandemic has tended to reinforce our national reflexes. In China, as in the U.S. and Europe, governments have responded quickly to the economic situation, but their stimulus programs are all aimed at reviving the local economy and local labor markets. That is understandable but may fall short with the challenge of a global crisis.

National initiatives can hardly solve global issues

Government initiatives to address climate change face a comparable risk: a too national or narrow focus will not solve the problem. In this new field of tension, governments must determine optimal ways to achieve their national goals and define their role in the new geopolitical energy world. In many cases, the path to a secure, clean and affordable energy supply also requires support, whether through the exchange of experience or funding as part of regional and local stimulus programs. The winners of the transformation could be found among the regions and countries that already have the lowest electricity costs for renewables, such as Africa, Middle East, China, the U.S. and other individual countries. Europe, as a strong energy importer, will become even more dependent on affordable energy to be competitive. The ongoing energy transformation in China and its carbon neutrality pledge present opportunities as well as challenges for multinational corporations. It is one of the countries which needs to realize the coal-to-gas transition, providing safe energy supplies to industries and people. By working together with local partners there are massive opportunities in China in energy infrastructure including power transmission and renewable energy.

Thus, we have to think globally about the energy transition. And we must not forget the countries that are today heavily dependent on revenues from hydrocarbons. Such countries need a helping hand if they cannot manage the energy transformation on their own because they lack the financial resources. The Paris Agreement explicitly states that it is up to the industrialized nations to support the developing countries in the energy transition. But is this already a reality? I don't think so, at least not to the extent needed to achieve the energy transition. It is one of the tasks of the industrialized nations to support such countries, also in their own interest, because energy and (political) stability are closely linked with each other.

No technology should be excluded

Anyone who takes a serious look at the energy transition will recognize that fossil fuels will play a relevant role in the overall energy mix for some time to come, and that there is a need for transitional solutions on our way to a sustainable world. On the path to climate-neutrality, no technology should be excluded just because it may not immediately lead to climate neutrality. What is important is that we start reducing greenhouse gas emissions today. This requires the courage to accept transitional solutions such as efficiency improvements or the use of cleaner fuels as e.g. natural gas. We need profitable business cases, to push investments in technologies such as Power-to-X and we need to actively promote innovations in the storage, transmission and use of energy as well as cybersecure digital solutions. Green hydrogen will be one important lever to develop sustainable solutions, especially in hard-to-abate sectors of industry and mobility. However, producing green hydrogen will require large amounts of green electricity. It will therefore be necessary to accelerate investments in electrical networks and infrastructures. If we look ahead ten years, the ambition to develop 40 Gigawatt of green hydrogen production capacity in the European Union is achievable, but it will require bold decisions and large-scale projects.

And in addition to technology openness, there is another challenge that we must master as a society: technology acceptance. Since the beginning of the Industrial Revolution in the second half of the 18th century, mankind has achieved almost unbelievable things in terms of technology. Technology has broken down barriers, made the impossible possible and made life easier in many areas. This will continue to be the case. As an engineer, I firmly believe that a great deal will still be technically possible, even if not from one day to the other. However, technological progress will only come if we talk about functioning business models – this will require targeted support from government organizations and appropriate regulation – and only if society supports the change. Germany certainly serves as a rather bad example of how approval procedures can drag on for decades in some cases. The energy transition cannot succeed at this pace. We need a rapid expansion of renewable capacities, which also means that more people will have to live with wind turbines on their doorstep, to name just one example. Without this social acceptance, an energy turnaround is not possible.

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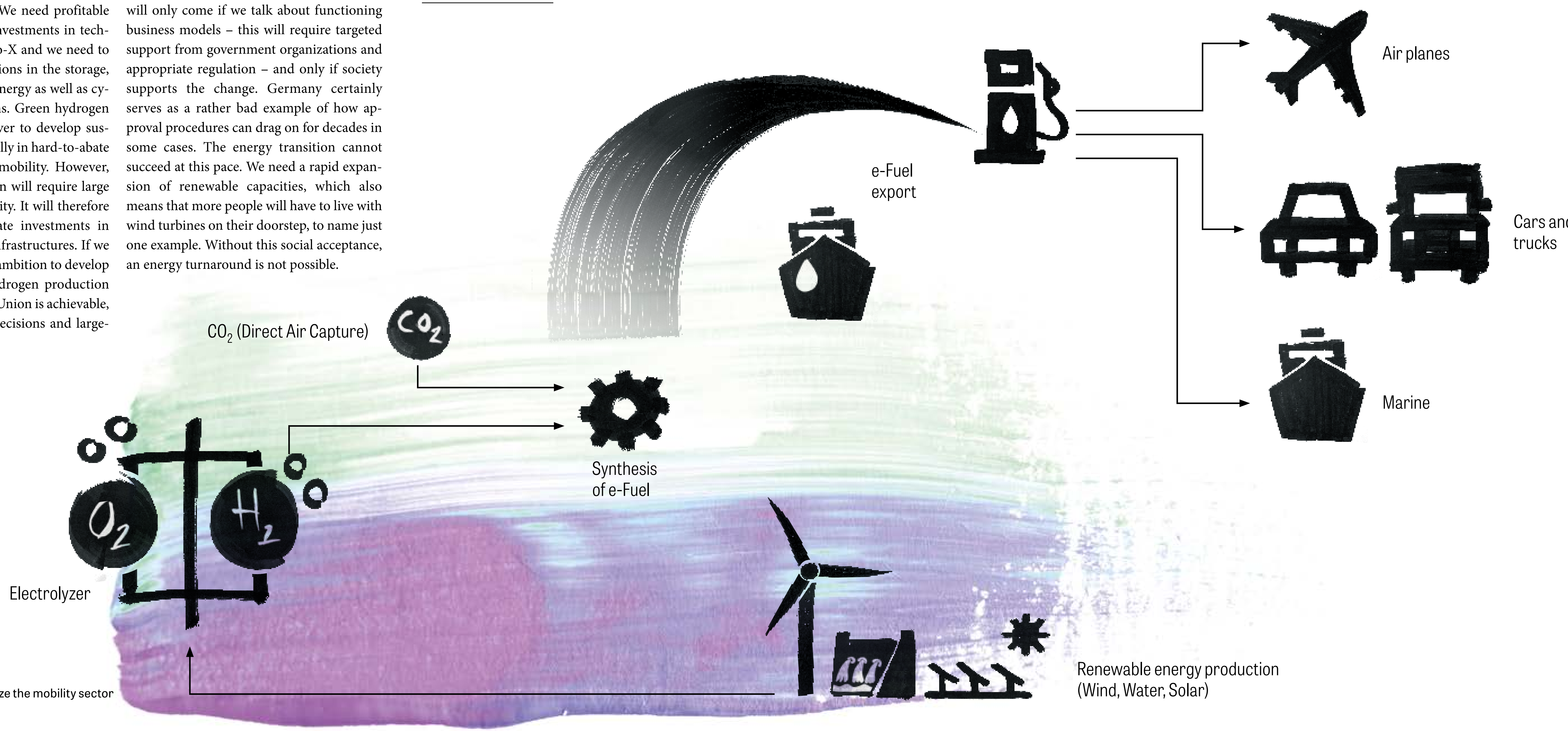


Figure 1: How to decarbonize the mobility sector

Companies are places of innovation and role models

Companies play a central role in the transition: They are both places of innovation and role models for setting and actively pursuing climate targets. For us at Siemens Energy, for example, it is important to drive the development of a hydrogen economy in partnerships. Producing fuels from wind, water and CO_2 captured from the air becomes reality in Chile. That liquefaction of clean electricity and its exports in the form of carbon-neutral fuels is one of the best ways to take advantage of the large wind or solar energy potential, available in even remote areas. Within this project, a broad spectrum of innovative, climate-relevant technologies to produce climate-neutral synthetic fuels will be demonstrated at one location. In this form, the project will set global standards. To make a significant contribution in the decarbonization of power grids, we as Siemens Energy will also successively switch to SF_6-free products. Recently, the Science Based Targets initiative has verified our emission reduction targets. The initiative confirms on a scientific basis that our CO_2 reductions contribute to limiting global warming to the extent stipulated in the Paris Agreement.

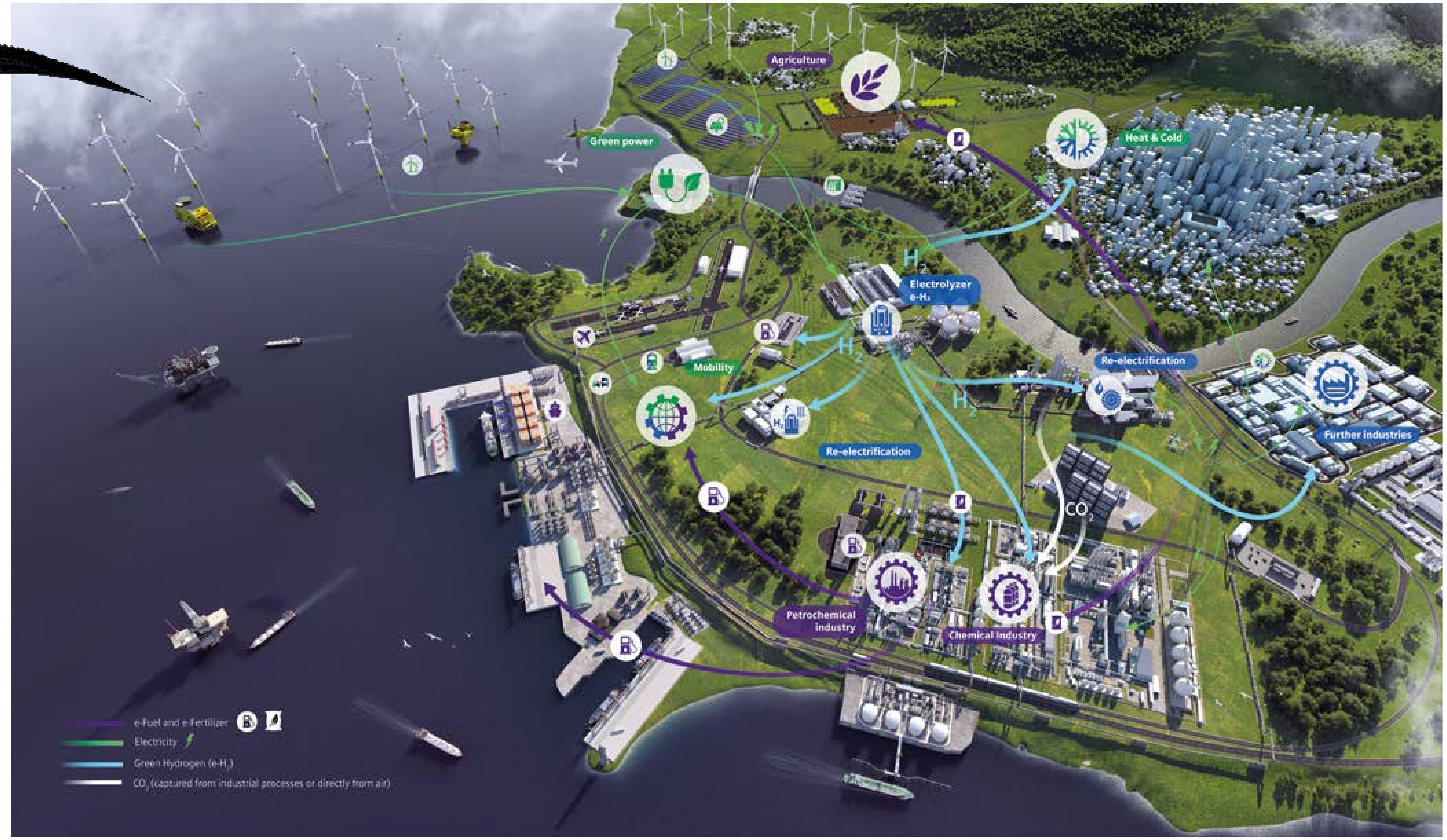


Figure 2:
Power-to-X: On the way to a carbon-free world

The challenge of climate change cannot be met unilaterally – we must see and seize this challenge as a global opportunity for change.

Making the energy transition a success

Managing energy transformation will only be successful if we enter global multi-partnerships, modernize conventional technologies as effective transitional solutions, and develop even more innovative, green technologies. Together, we can bring about the acceleration necessary to achieve the ambitious climate targets that have been proclaimed many times. We need to collaborate and share innovations rather than compete. The challenge of climate change cannot be met unilaterally – we must see and seize this challenge as a global opportunity for change. We need to work together to create a global environment of technology openness and innovation friendliness to collectively succeed in the energy transition and to fight climate change.

The Future of Medicine: Accelerating Digitization in Healthcare

Why we Need it and Where we Struggle

Prof. Dr. Christoph Franz
Chairman
Roche

Annette Mönninghoff
Institute for Customer Insight
University St. Gallen

The Covid-19 pandemic has put the spotlight on the lack of digital infrastructure in today's healthcare systems and demonstrated why digitized healthcare is a competitive advantage.

The Covid-19 pandemic has hit us by surprise. When news about an unknown virus started spreading in January 2020 and an increasing number of new cases were detected daily around the globe, we were not ready to manage a global pandemic.

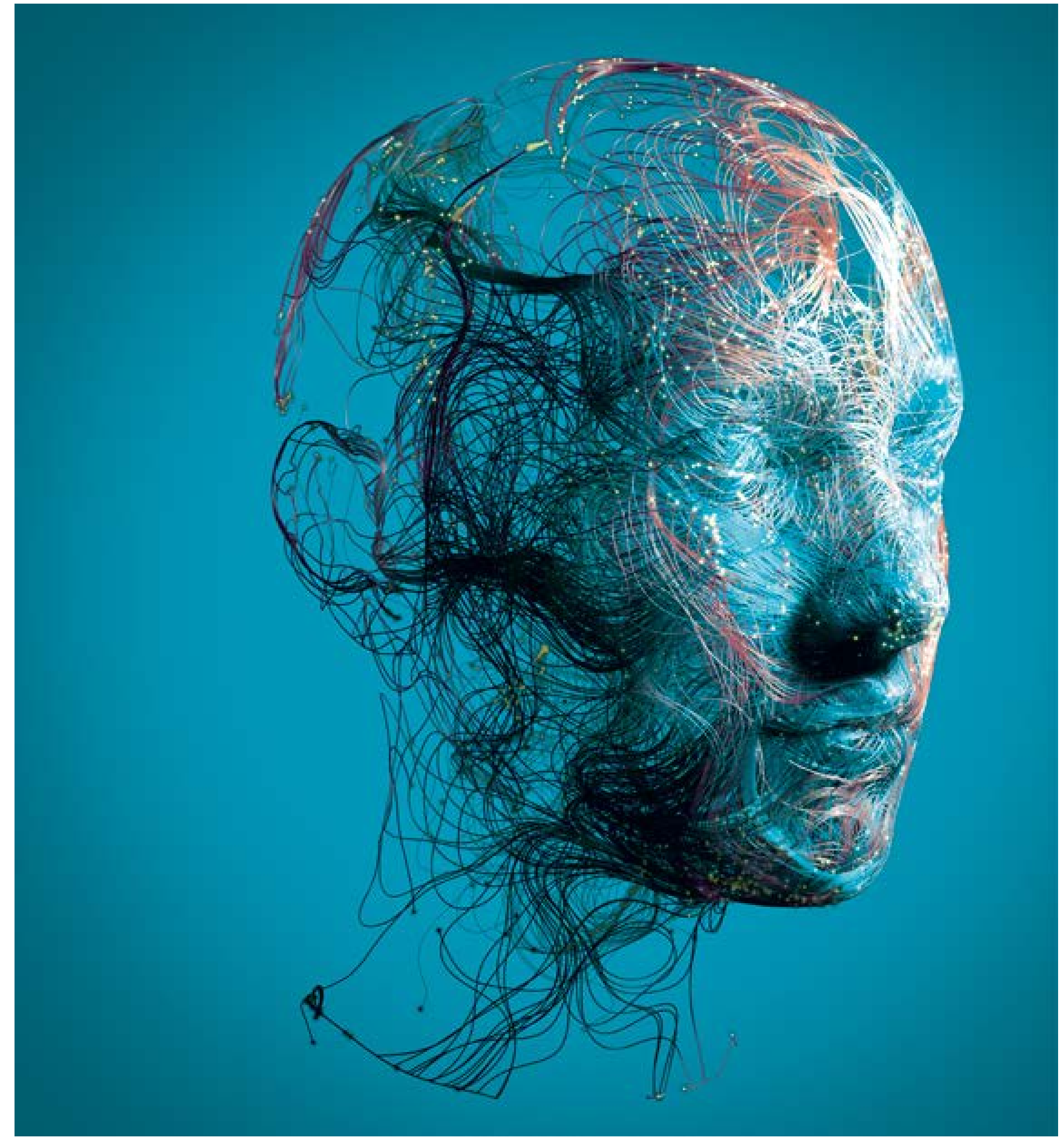
You can't manage what you can't measure

Particularly in Europe, healthcare systems were not built to efficiently consolidate infection numbers at a national scale. Instead, labs or clinics in Germany, for example, were communicating test results to regional public health offices via FAX, telephone or non-standardized emails which were then hand-typed into the public health offices' systems. It took Germany six months to introduce a digitized detection system (DEMIS) that allowed labs to electronically communicate Covid test results to the national institute for disease control and prevention, ultimately speeding up the information flow and significantly improving data quality. The lack of digitized information flows is just one example for the underdevelopment of healthcare systems with regard to digital capabilities. Today, more than one year into the pandemic, many of the national contract tracing apps in EU countries are yet to be fully accepted and used by the population. Also, Germany is still struggling to transfer the millions of originally analog vaccination records into the EU's digital vaccination pass.

> The lack of digitized information flows is just one example for the underdevelopment of healthcare systems with regard to digital capabilities.

Digitized healthcare brings competitive advantage

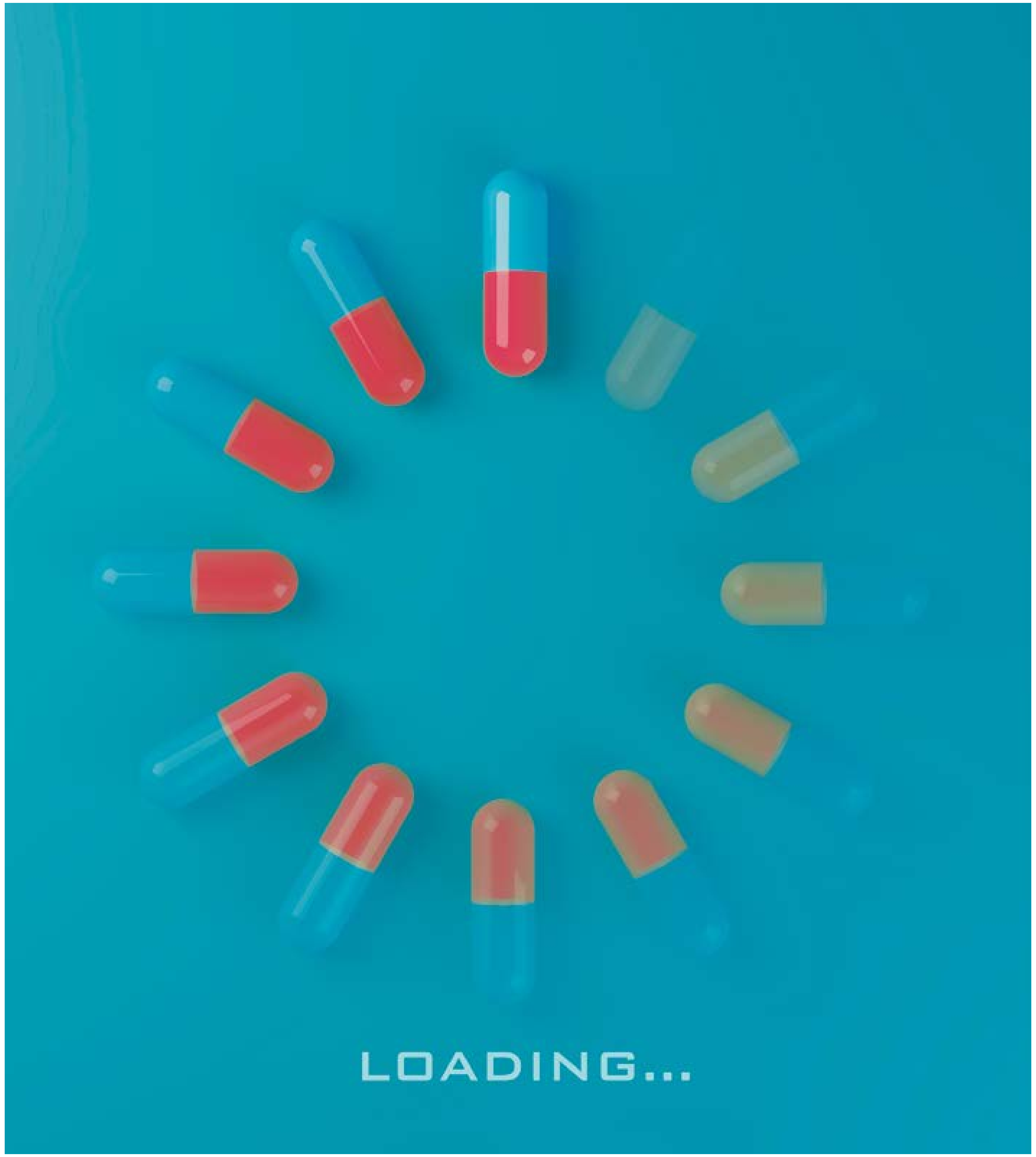
In contrast, the backbone of Israel's healthcare system is digital, which comes as a competitive advantage, not only in times of a pandemic. The highly centralized Israeli system builds on a history of over 25 years of electronic medical records (EMR) for every citizen, allowing the country to coordinate their vaccination campaign seamlessly and effectively. Because of Israel's comprehensive EMR infrastructure that systematically consolidates medical information in machine-readable, anonymized databases, the country could provide immediate feedback on vaccination success rates and side effects, along with demographic and medical record data for all vaccinated citizens. Taking advantage of this dataset, vaccine producer BioNtech/Pfizer offered prioritized distribution to Israel, leveraging the country as a pilot case for the real-life effect of a national vaccination campaign on pandemic dynamics. Without its digital health infrastructure, Israel would not have been able to re-open the country as fast as it did.



Why we need to accelerate digitization beyond the pandemic

We argue that beyond the Covid-pandemic, we need to accelerate digitization in healthcare in order to future-proof healthcare systems and to capitalize on countless opportunities:

1 **Digitization accelerates medical progress:** Medical progress in recent decades has led to an exponential increase in the complexity of medical research. Increasingly, real-world data (RWD) complements findings from traditional clinical trials. Together with ever smarter artificial-intelligence (AI) based tools, RWD opens the door to predictive medicine at scale. This is particularly relevant in researching conditions where preventive care has the greatest effect. According to what we know today, Alzheimer's disease is one such condition. Every year, 10 million people develop Alzheimer's disease, and the number of cases rises sharply as the population ages. RWD allow us to systematically search for clues that help us better understand diseases and their development, and to diagnose them at an earlier stage. In the future, the success of pharmaceutical companies will not only depend on the best natural scientists, but also the best software engineers and access to the best anonymized health data. For societies, a digitized healthcare system and quality-controlled, machine-readable health record databases will become a competitive advantage. China, the United States, and Israel are heavily investing in these capabilities, Europe needs to catch-up.



2

Digitization improves the quality of healthcare: Until the 1950s, the rule of thumb was that it takes half a century for medical knowledge to double. Today, experts estimate that medical knowledge doubles every 70 days. This leads to complexity and a flood of innovations that cannot be mastered by humans alone. To further improve the quality of healthcare, doctors will increasingly be augmented by digital assistance systems. Such systems rely on AI and will support image-diagnosis, suggest treatment paths and ensure that even less experienced doctors follow treatment guidelines, hereby avoiding mistakes and improving the quality of care. To future-proof healthcare systems, we must invest in digital assistance tools and encourage research at the intersection of medicine and computer science.

3

Digitization creates efficiencies: Growing medical costs are a major challenge for healthcare systems especially in demographically aging societies. While some cost drivers like demographic change are unavoidable, there are others that are caused by inefficiencies and waste within the system. Digitalization can play a decisive role in reducing or preventing inefficiencies, which in turn can alleviate some of the cost pressure being experienced by healthcare systems. There are many areas where treatment is inefficient. Emergency rooms are one such example. Statistics show that when people come to emergency rooms, this is medically unnecessary in 71% of cases. These visits could have been avoided. Digital triage apps can help guide patients to an appropriate and more cost-effective treatment option. Digital health companies like Oscar Health have pioneered such apps with proven success, herby reducing healthcare costs without compromising on quality of care. In order to manage rising medical costs in the future, we need to implement connected networks of insurers, providers and patients that increase cost transparency and push performance-based remuneration schemes.

4

Digitization improves access to healthcare: Digitization is the key, if not the only way, to provide the 3.4 billion low-income people globally, those who earn less than $5.50 a day, with access to quality healthcare. The World Health Organization estimates that by 2030, we will be facing a shortage of 12.9 million healthcare workers globally. The situation is particularly acute in Sub-Saharan Africa and Asia. But also, in Europe, remote areas have been faced with thinned out healthcare networks. Telemedicine can extend access to medical care in remote places, remote diagnostic tools efficiently bring expert knowledge to lower-skilled healthcare centers when needed, smart digital assistants can relieve doctors from administrative tasks, thereby freeing up much needed medical capacities. To improve access to healthcare, we need to improve mobile-phone and data networks, and to integrate telemedicine and remote diagnostic services into regular care networks.

5

Digitization supports preventative care: The most fatal diseases are not infectious diseases, but non-communicable diseases such as diabetes, cardiovascular illnesses, or cancer which cause the majority of deaths worldwide. To a large percentage, the risk of getting these diseases is driven by modifiable lifestyle-related factors. Smoking causes 8 million deaths per year, insufficient physical activity 3.2 million, and excess salt consumption 2.5 million. Instead of treating a growing number of patients with chronic illnesses, the focus must shift towards prevention. Mobile digital health solutions (mHealth) can effectively support behavioral change towards healthier lifestyles. Because of their ubiquitous nature, they provide scalable and cost-effective solutions to support health behavior change in large populations. mHealth solutions also expand the reach of doctors beyond their clinic and offer continuous patient support, which improves therapy outcomes for chronic illnesses. The diabetes app MySugr showcases how supplementing traditional care with mHealth solutions improves quality of care. To future-proof healthcare systems, we need to leverage mHealth solutions to supplement current treatment regimes, and to transform healthcare systems towards a prevention-oriented system that safeguards health instead of treating diseases.

Statistics show that when people come to emergency rooms, this is medically unnecessary in 71% of cases. These visits could have been avoided.

This article is partly based on the book "The Digital Pill" by Prof. Dr. Elgar Fleisch, Prof. Dr. Christoph Franz, Prof. Dr. Andreas Herrmann, and Annette Mönninghoff.

John Rogers
CEO and Co-Founder
LM Industries Group

The Time for Vehicle Autonomy is Here

The world is facing the major challenge of guaranteeing sustainable mobility and energy supply while meeting climate targets.

The Vision is simple – a car that drives itself. If it was good old Herbie in the sixties, Knight Rider's KITT or the Batmobile as seen in the 1989 film…It is a vision of the future as simple and compelling now as it was decades ago.

So where is that "future"?

The truth is that the autonomous future is here, it's just not very evenly distributed. This idea of "future" technology being among us in the present is a common trope whose origins are attributed to William Gibson, American speculative fiction writer, and also to other well-known industrial policy thinkers and historians such as Alvin Toffler in Future Shock and Peter Drucker in his 1989 Economist article entitled "The futures that have already happened". (https://quoteinvestigator.com/2012/01/24/future-has-arrived/).

I founded Local Motors to build new technology vehicles in 2007, and we put our first fully autonomous vehicle on the road in 2015. Since that time, a day doesn't go by where people haven't said to me, "I didn't know they were actually here?" The truth is that so many people have so many more questions… "Why is it happening just now?" "Is it realistic that it has taken 50 years?" "When will it help me and my life?"

And that is why I have written this article.

The time for autonomy is now

For some perspective, in similar world-changing technology, the development of semiconductors took the same duration – half a century – before they were obvious and replete. They started as a US national research priority in the mid-20th century, and then one day in 2007, we waited in line at the Apple Store and walked out to a brave new world with supercomputers in our pocket. Silicon microprocessors had come of age. In truth, they had been all around us in boxes and machines of different sizes for decades as they approached the size, shape and affordability of a smart phone. In short, it was an overnight success… 50 years in the making. In major revolutions, often step-by-step building blocks drop into place quietly over time. The ultimate or resulting victory often cannot be enjoyed nor predicted even at the placing of the penultimate block. It is often not until the last block is dropped into place that people perceive the future victory as now and theirs to make their own.

For driverless vehicles, the duration has been much the same and in the last 50 years, massive necessary building blocks have been quietly dropped in place all over society, technology, economy, and the globe.

John Rogers The Time for Vehicle Autonomy is Here

The building blocks to autonomy

Affordable Technology – Autonomous Vehicle Technology is now available at an affordable price:

- Robots such as a common vacuum Roomba from iRobot or a weaponized drone from Lockheed Martin that can sense, process, and actuate to complete missions half a world away from their owners.
- Massive cloud information storage is accessible with edge connectivity, purchasable from multiple vendors on a pay by the month basis.
- Low-latency communication protocols originally for submarines are now used for texting-in-process alerts on smart phones
- Acceptable cyber-security protections in accordance with rigorous GDPR standards are de rigueur.
- Provable machine learning and discrete artificial intelligence are here from various software vendors for adaptive processing by a machine.
- Light ranging and detection sensors can see 300m in the dark, operate in the snow, and sample millions of points per second.
- Radar can see speeding objects through fog.
- Visual cameras can perceive depth when married with infrared imaging thanks to video games.
- Simultaneous location and mapping (SLAM) have reduced reliance on global positioning systems thanks to DARPA.
- Tensor flow processors are available for handling massive image processing and object classification tasks on the same architecture as CPUs and GPUs with ASILD level compliance.
- Even if one doesn't know that some of these tech blocks have been laid, the point is that most people make use of them without notice.

Human Habits – Human Habits to share rides and everything else have become a commonplace offering from Uber, AirBnB, eBay and others.

Electric Vehicles – EVs have created the most valuable vehicle companies from Tesla to Geely…and have challenged traditional automotive OEMs.

Digital Vehicle Production – where ERP, PLM, CAD and CAM software can be used to design, render, plan, order and 3D print a vehicle faster than a traditional car maker have arrived.

Insurance – New Liability and Loss Insurance plans where pedestrians can pay by the click to be covered for the loss of a concert ticket are available by app.

Financing – Fleet Financing and Residual Value Insurance have been built into businesses where the value of new vehicles can be rapidly established and covered for the benefit of lessors.

Cargo – eCommerce accessibility to every PC and connected home and phone and its handmaiden of exponential delivery expansion from mail services and couriers alike are a click away.

Smartphones – Mobile payments, preference storage and authentication through everyone's smartphone are here starting with PayPal and now proliferating to hyperwallets and digital currency.

And Motive – Most importantly the building blocks of Motive are ringing alarms: Today, 1.4M people die per year (3,700 a day) in the world, in human-engendered vehicle accidents (https://www.cdc.gov/injury/features/global-road-safety/index.html). The loss of life is tragic, incalculable, and avoidable. At the very same time, humans struggle valiantly with piloting our vehicles on commutes and errands throughout every day resulting in a loss in the US alone of $0.85 of productivity per mile based on an average salary of $24/hour and an average speed of 28mph (data excerpted from "Autonomy" by Lawrence Burns and Christopher Shulgan). This may not seem like a lot lost until you realize that in the United States alone we drive 3 Trillion miles in one year, resulting in $2.6 tn of lost US productivity. That is almost $700 bn more than the entire US national debt. So, the stakes are high and the potential win is enormous for each country that seizes this victory. And if life saving and economy saving motives were not powerful enough, there is the fact that there is an exponential growing chunk of population without accessible mobility, there are dwindling global fuel supplies, and we all see harbingers of environmental destruction. The motives are enormous.

So…

In major revolutions, often step-by-step building blocks drop into place quietly over time. The ultimate or resulting victory often cannot be enjoyed nor predicted even at the placing of the penultimate block.

Here is why it may not be in your neighborhood

Autonomy is coming in a stepwise function. Community by community it is here in affordable, aligned, business models where there is a market.

But it has its price: at last count about $350–500,000 for the robot driver of a passenger car. So, basically this is asking a school teacher to buy a Bugatti. Commensurately, there is also no legislation for these new vehicles as average voters don't need such tools yet at that unaffordable price. But…there is a market for shared mobility in dense environments for both people and products to get around and that is here – today – in your neighborhood. We can share them.

One of my mentors taught me early in business, that one should never be surprised when the best-laid plans actually work. Planning has been going on in earnest by many of the most capable actors around full autonomy solutions and we should no longer be surprised.

The Actors – businesses and government contributing today

Amazon+Zoox, Nuro.ai, Local Motors, GM+Cruise, Waymo+Chrysler/Jaguar, Ford+Argo, Robotic Research+US Army… among many others, these teams are all already providing full vehicle autonomy in shared solutions. They are standing on the blocks laid before them and reaching to place more stones in the pillar to reach your neighborhood.

Commensurately, legislation and regulation in discrete areas have responded to the step-wise movements in innovation and business models. As one of many examples, in Germany, in the latest bid to support an alignment of interests, the Bundestag, Bundesrat, and German Federal President have catapulted the European powerhouse to the first nation in the continent to allow for stewardless autonomous vehicle operations. In May of 2021, the legislature passed a law which set the imminent technical conditions for permitting operations without a steward as long as riders were given a measure of control, and that remote supervision and teleoperation were activated. This is but one example of responsive government in the face of autonomous technological progress. There are others in the U.S., Saudi Arabia, Korea, and China that aim to keep pace.

Here is a sample chronology of how fast legislation can adapt in a country such as Germany:

Bill on automated driving:
Approval of the bill on automated driving determining the rights and obligations of the driver during the automated driving phase.

June 21, 2017

Draft bill passed by the cabinet:
Passing the bill by cabinet Merkel IV and subsequently forwarding it to the German Bundestag and Bundesrat.

February 10, 2021

Expert hearing and approval:
Hearing and approval of the lead commitee for transport and digital infrastructure (AfVI) in the German Bundestag.

May 3, 2021

Bill passed by the German Bundestag:
Passing the bill by votes of the coalition parties and the liberal democratic party.

May 20, 2021

Bill approved by the Bundesrat:
Approval of the bill.

May 28, 2021

Bill signing by the Federal President:
Signing by the Federal President and promulgation in the Federal Law Gazette. This means that the law could enter into force within the next few weeks.

June/July 2021

So take heart the revolution is upon us and your life will change. Our belief is that this change will look like this following example from now forward.

In 1907, there were 3000 vehicle companies and entrepreneurs who had laid the building blocks of motorized transport as Henry Ford stepped up and placed the final block. These final images serve as a poignant reminder of how human lives changed forever in that decade. On Easter Morning on 5th Avenue in New York in 1900, there was 1 motorized vehicle to be found in a herd of carriages and horses. 13 years later…well, revolution. You cannot find a horse.

Easter morning 1900:
5th Ave, New York City.
Spot the automobile.

Easter morning 1913:
5th Ave, New York City.
Spot the horse.

Triumph of Sustainability

The European Green Deal and its Regulatory Challenges

Europe has set itself the goal of becoming the most sustainable continent on the planet and to reach climate neutrality by 2050. To make this a reality, the EU Commission is paving the way forward for 450 million Europeans with the legislative framework of the Green Deal.

Dr. Nicolas Peter
CFO
BMW AG

The scale of the transition requires strong and comprehensive cooperation between governments, society, investors, industry, and the wider economy. To achieve the visionary and ambitious goals, Europe needs a holistic sustainability approach – from the financial market to mobility, with far-reaching impacts on society and individual lives.

For European companies, such as the BMW Group, the Green Deal and its aim to reach a climate-neutral economy are both an enormous challenge and an opportunity. However, it requires an appropriate regulatory framework to ensure that Europe's climate leadership and transition to a more sustainable economy will become a resounding success. European companies are ready to act – but the policy framework must ensure competitiveness and support industrial transformation.

European industry supports the European goal of climate neutrality by 2050. The question of financing this ambitious project is essential.

Large investments, including from private investors, is needed to decarbonise the EU and make it energy efficient.

According to the European Investment Bank, around €270 billion in investment in mobility, energy and resource management is missing annually to meet EU climate and energy targets. The financial sector can play an important role in strengthening these investments for sustainable growth, job creation and prosperity.

In the transformation to a sustainable Europe, the Commission envisions a key role for private capital. On this basis, investors should be able to target environmentally sustainable economic activities. The financial market is already assisting in financing the Green Deal and pulling in private investors – currently we can already see tangible results in the increasing volume of so-called Green Bonds.

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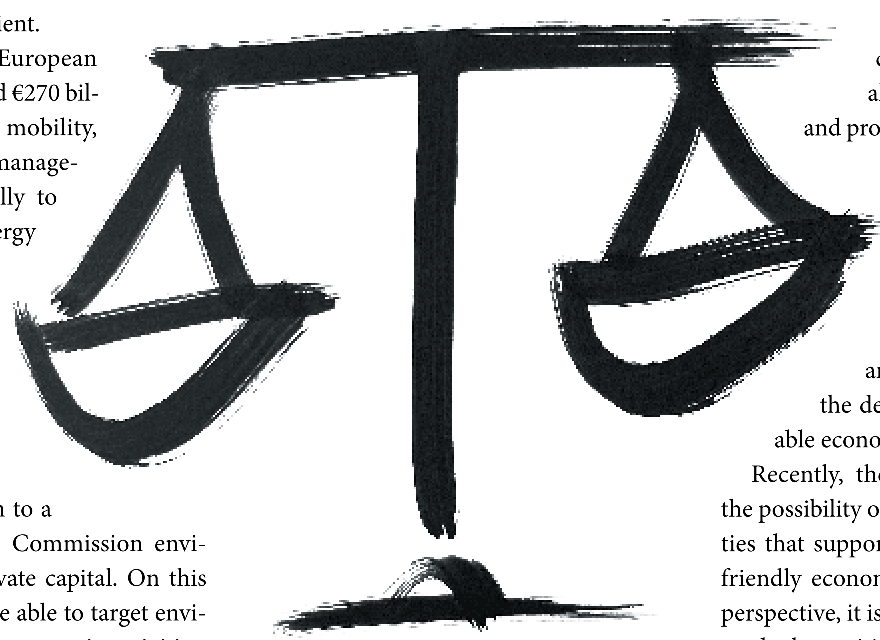


Moreover, in July 2020, the EU Taxonomy regulation entered into force, establishing a classification system for economic activities of financial market participants and large listed private companies. Moving forward, investors should be able to see – through the adoption of this taxonomy classification in corporate reporting – which economic activities qualify as sustainable.

Evaluation of sustainable activities

In a first step, only activities which serve to protect the climate or support adapting to climate change will be considered environmentally sustainable. Here, the EU Commission has set very little room for interpretation: the final legal act explicitly defines which activities are to be considered environmentally sustainable.

According to estimates from consulting agencies, only about one to two percent of current revenues from the entire European manufacturing sector would be recognized as compliant under the taxonomy.

The result of such a narrow classification, which is actually aimed at achieving a rapid and profound transformation, will be a wide-ranging blacklisting of European industry, potentially leading to significantly reduced investments in certain industrial sectors that play an important role in driving the desired transition to a sustainable economy.

Recently, the EU Commission signaled the possibility of adding a category for activities that support the transition to a climate friendly economy. From the BMW Group's perspective, it is critical for the EU to foster a gradual transition which encompasses more economic activities. This will ultimately lead to better results and a smoother process for all stakeholders. In the automotive industry, we see a similar situation with the Euro 7 norm for combustion engines. Manufacturers

welcome a strict, yet clearly defined regulation, which will produce the most advanced and cleanest technology, as OEMs transition more towards electric drivetrains. However, tightening the norm significantly without a gradual transition would interrupt the transformation process and could even lead to de facto bans on efficient combustion engines before the industry's transformation is far enough along.

In the taxonomy, the European Commission has expanded the disclosure requirements for listed companies with more than 500 employees. Beginning with the financial year 2021, companies that fall under the Non-Financial Reporting Directive are required to report on the proportion of their revenues, capital expenditure and operating expenditure that qualify as environmentally sustainable.

The EU Commission has set very little room for interpretation: the final legal act explicitly defines which activities are to be considered environmentally sustainable.

Standardizations simplify the process

The implementation of the EU taxonomy requires complex and costly modifications to the reporting structures and processes of European companies. To fulfil these new requirements, additional IT-based (non-financial) reporting systems are necessary – not only for companies required to disclose, but also for suppliers and other business partners along the entire value chain. It is therefore important to have standardized and easy-to-implement definitions for key figures in order to effectively collect and consolidate this information and – a key aim of the European Commission – to achieve comparability.

The details of the reporting requirements, however, have not yet been published in their final form by the European Commission. But the application of the regulation remains unchanged meaning that key figures must be collected retroactively for the first months of this year, with implications for quality, accuracy and ultimately comparability.

Furthermore, all aspects of sustainability must be considered – not just environmental – but also social and governance, the so-called ESG aspects.

However, companies need sufficient lead time to implement new comprehensive regulatory requirements as is, for example, common with the International Financial Reporting Standards.

The EU taxonomy can mobilise private capital to promote the sustainability of European economic activities and companies can contribute to the achievement of the EU's sustainability goals.

However, the EU taxonomy is only one building block to this end, but a very central one. The revision of the Non-Financial Reporting Directive – the so-called Corporate Sustainability Reporting Directive – and the planned development and establishment of European standards for sustainability reporting are further pieces of the puzzle.

Global solutions also for local operations

Global companies specifically benefit from global standards. In this way, for example, IT reporting systems – even for local reporting – must be parameterized only once. The goal should be to focus on just a few non-financial indicators, presented and described in detail.

The European Commission must avoid establishing its own standards for sustainability reporting. A specific European norm would only increase the risk of creating unequal conditions of competition and could be even detrimental to funding flows within Europe.

Companies must therefore be fully involved in the development of standards. Reference should also be made to existing international standards and frameworks. These have been globally established for years, are recognised worldwide and are already being used by companies as a basis for their sustainability reporting.

A global and generally accepted standard would therefore be desirable in this context. This would allow companies to significantly reduce their reporting costs, while significantly increasing the transparency, quality and comparability of sustainability reporting.

Current international initiatives, in particular the IFRS Foundation, should therefore be supported. A European standard, on the other hand, entails too much risk and additional effort for the companies concerned.

Ultimately, it is important that new standards and reporting requirements are easy to implement on the corporate side. The ambition of the EU's climate goals is exactly what is needed to tackle the climate crisis – but European companies need to be consulted in the process. Companies are more than prepared to act and accomplish their own ambitious sustainability goals. The regulatory framework, however, needs to complement these corporate goals to help companies remain competitive globally, while setting the pace on ESG measures.■

Defending Europe's Economic Sovereignty with Stronger Capital Markets

As Europe takes tentative steps towards a recovery it must urgently re-engage with its pre-corona long-term challenges – many of which have become yet more acute during the pandemic.

Paul Achleitner
Chairman of the
Supervisory Board
Deutsche Bank

LEADERSHIP

Wealth inequality among citizens has soared and on a state level, economic performance among EU members continues to diverge, with post-pandemic data suggesting worse to come.

Geopolitically, the world continues to move apart as conflicts with Russia, China and others risk further damaging multilateralism, confidence and trade. Europe's loss of economic ground to China and the US presents an acute threat of being permanently left behind. We Europeans must act now. This is more important than GDP: economic strength translates into political and social independence, allows us to set our own standards and avoids undue dependence on foreign companies with different values, standards and politics.

It's clear that even if we wanted to, we cannot simply return to the pre-corona world. European society has two imminent, overarching economic objectives. Both show similar challenges and have huge funding needs:

1. the **transition** to a zero-carbon economy
2. **digitalization** for the benefit of citizens.

Embracing the digital age and tackling global warming are the most profound, far-reaching issues of our time that will shape the future of our continent for generations. Europe has not been a first mover in digitization, but innovations such as artificial intelligence and Industry 4.0 still offer huge opportunities. But they also pose existential risks for those who do not keep pace. Climate change poses existential risks for all and countering it requires fundamental changes to our societies and economies.

The need for enormous investment underpins both projects: without new technologies and adequate, appropriate financing, Europe cannot become more digital or more sustainable. The NextGenerationEU recovery plan is welcome but insufficient. To master digitization and climate change while managing the fallout from Covid, Europe needs three levers:

1. **Leadership**, in politics and business
2. **Innovation**, leveraging new technologies
3. **Funding**, making better use of capital markets.

Leadership

Such a complex, fundamental task requires business and political leaders with vision, who are willing to take risks and play a long game. To compete with the US and China, we need more Europe, not less, which requires leaders who can unite member states. We need farsighted legislators to set a regulatory framework that does not put companies at a disadvantage versus their non-European competitors.

But as the pandemic has drastically demonstrated, leadership is also about getting things done. Process matters but so do results. Implementation is key in politics as well as business.

A strong Europe needs strong companies and globally competitive banks. The fundamental transformation we need means many companies will have to reinvent their business models – which requires the courage to embark on the unknown. This needs entrepreneurial spirit and courageous leaders in traditional industries to drive change.

Innovation

The reforms necessary to leverage digitalisation and drive the innovation that powers it need urgent political leadership and public-private cooperation. Our actions will determine Europe's economic success and wealth for decades – but also the degree of technological, digital and – in the end – political sovereignty we retain.

Deutsche Bank wholeheartedly supports the European Innovation Council (EIC) and its mission to give start-ups in Europe the same opportunities for growth and financing as their Silicon Valley counterparts. This should form the basis of a movement to turbocharge Europe's innovation and start-up culture, including a supportive regulatory environment and public investment in digital infrastructure and R&D.

We have the educational infrastructure and quality of life to attract the best talent. Europe's diversity should also drive innovation. "Should", because renationalisation, cancel culture and groupthink are the natural enemies of true innovation, which is a product of intellectual curiosity and diversity coupled with a culture of debate and challenge.

INNOVATION

Europe must also become better at leveraging disruptive technologies, for instance, by encouraging local alternatives to American or Chinese platforms.

Most importantly, we must provide the complete range of financing for entrepreneurs – from early-stage to IPOs. The EIC's €10bn budget is welcome but will not be sufficient to stop the brain drain to more supportive tech hubs. A stronger European capital market would offer another source of funding for mature companies.

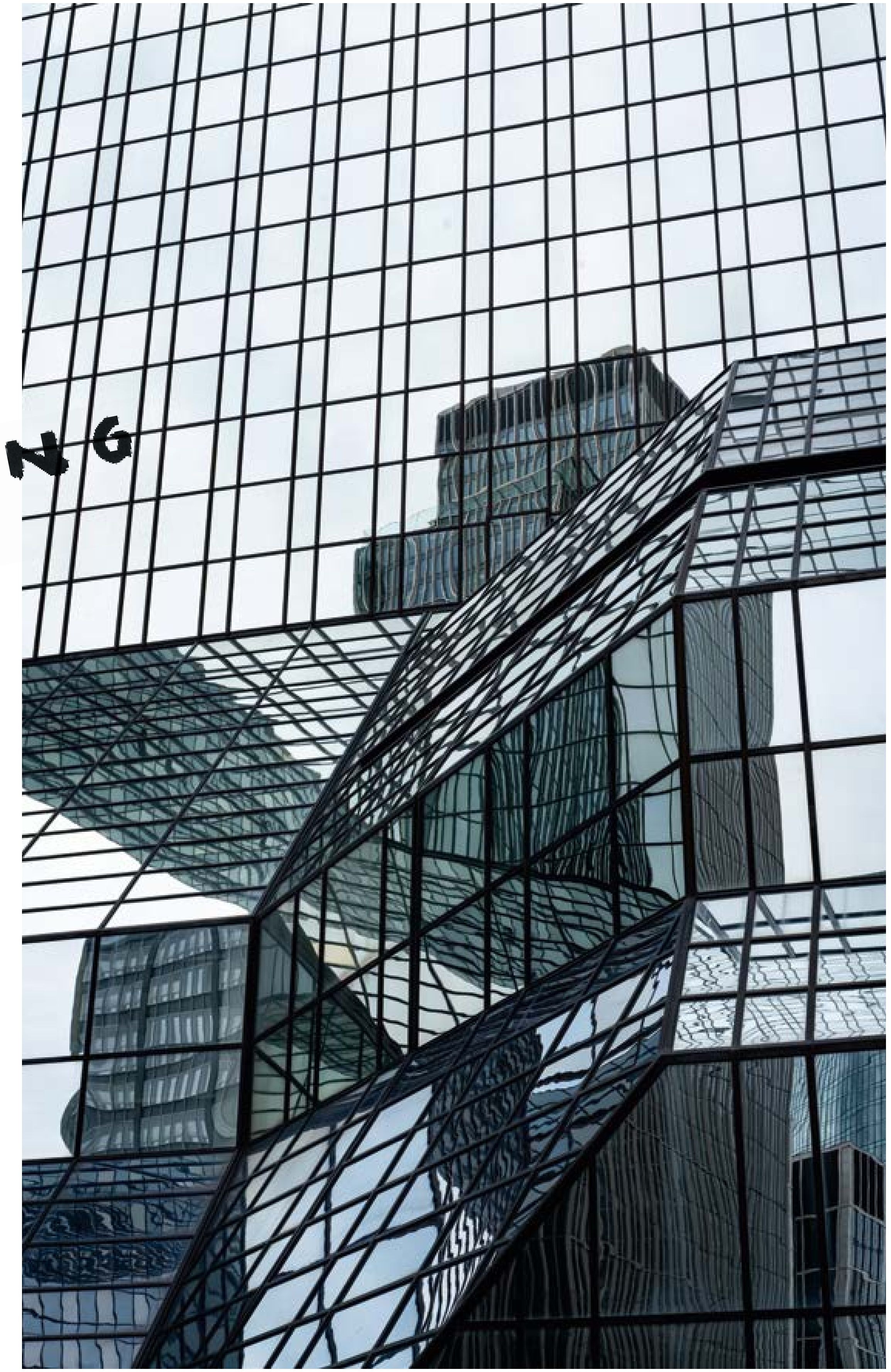
To compete with the US and China, we need more Europe, not less, which requires leaders who can unite member states.

Our actions will determine Europe's economic success and wealth for decades – but also the degree of technological, digital and – in the end – political sovereignty we retain.

Funding

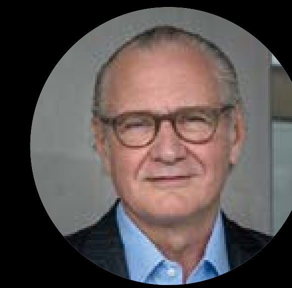
FUNDING

Investments in technology will be dwarfed by the financing needs of tackling climate change and transitioning to a sustainable economy. Given that the EU's Green Deal alone will require €1 tn of investment we must urgently address this funding gap. Taxpayers cannot and should not have to pay. The pandemic eliminated Europe's remaining inhibitions about debt but we cannot continue borrowing indefinitely.
Europe's banks cannot fill this gap alone, especially as balance sheets have shrunk in line with post-global financial crisis regulation. That leaves the only realistic source: private investors. Loose monetary policy worldwide has driven wealth to record highs over the past decade and a half and this private capital must be harnessed to transform Europe. The solution is a strong European capital market complemented by the appropriate financial sector expertise.
It is an issue many have been championing since the 1990s but little has changed: in Europe, more than 80 % of corporate finance still comes from bank loans – with capital markets contributing less than a fifth. In the US, around two thirds of debt capital comes directly from investors – and the equity capital market is also much larger putting it way ahead in innovation financing. The mood however is changing with a growing realisation that Europe cannot finance the transformation of its economy without stronger capital markets. Some hesitancy remains but the situation is clear: without an enhanced capital market there can be no rapid digitization, green deal or climate neutral economy.
To accelerate this, European leaders should create framework conditions that enable innovation and funding at scale. The new EU Taxonomy on ESG is a positive example that shows what is possible.
The foundation for a stronger European capital market is more integration – strength cannot come from a patchwork of 27 individual markets. The Capital Markets Union may not be a politically rewarding project but economically, we need this framework more urgently than ever. And we need the necessary expertise, which in an unpredictable geopolitical environment should not only come from outside Europe. We need more banks in Europe with capital market expertise and stronger capital markets for them to work with.



Conclusion – twin transformation drives future success

Europe must accelerate these long-term plans straightaway, even as it is preoccupied with kick-starting the economy post-Corona. There is no short vs long-term conflict here: adopting digitalisation and sustainability will directly drive European competitiveness. And many agree that companies which accelerate both transitions will enjoy the biggest boost – they just need to be able to finance it. To take these opportunities, it is clear that Europe's over-reliance on bank and government funding has to end. We need to finally unleash the power of financial markets. Advocates for this have generally felt like a voice in the wilderness – but now we are at a tipping point and nothing less than the future prosperity of Europe is at stake.



Dr. Stefan Oschmann
Chair of the Board & Independent Director at UCB; former Chairman of the Executive Board and CEO Merck

Lessons learned from Covid-19

How to make the world safer in the event of another pandemic.

Imagine a panel at the prestigious Munich Security Conference. The subject: pandemic prevention. The speaker: Bill Gates, a leading voice on this topic. So, do we see a frantic rush for participation? Heated discussions? Extensive media coverage? Nothing of the kind. The year is 2017, and as one of the panel's organizers, I remember we had trouble filling the room. Pandemics were seen as the stuff of history books or sci-fi movies back then.

We know better today. Three years after the Munich event, Covid-19 started its devastating campaign across the globe. And it has taught us a cruel lesson about the risks of underestimating pandemics. The truth is: The threat of infectious diseases has been steadily growing. The reasons range from increasing urbanization to climate change

The truth is: The threat of infectious diseases has been steadily growing.

to the interconnectedness of our world to the menace of bioterrorism. In his 2017 speech, Bill Gates estimated that the costs of preparing for a pandemic would be at around $3.4 billion a year while the annual loss in such an event could amount to as much as $570 billion. Nowadays, experts see cumulative losses due to Covid-19 in the trillions. And of course, the millions of people who have been infected with the virus pay a terrible price of their own.

Chances are that the mere extent of the current crisis will help to once and for all break the dangerous cycle of panic and neglect we have formerly seen with regard to epidemics. Indeed, countries previously hit by SARS or MERS proved more resilient when confronted with the novel Corona virus. So, how can we make sure the world is better prepared for the next crisis of this kind? Indeed, there is a lot we can do, mainly in terms of organization, collaboration as well as research and development.

Covid-19 has certainly exposed the weaknesses in public health systems in high-income regions like Europe and the U.S.

Universal Health Coverage protects all of us

As for better organization, there can be no doubt anymore about the importance of measures such as maintaining adequate stockpiles of medical supplies, creating sound emergency plans, or conducting regular outbreak simulations. At the same time, I think we need to take a broader view. We need to strengthen healthcare systems in general – worldwide. Covid-19 has certainly exposed the weaknesses in public health systems in high-income regions like Europe and the U.S. However, we need to understand that in avoiding pandemics, the global community is only as safe as its weakest member. After all, viruses do not care about borders. And if a dangerous pathogen first emerges in a country with a poor health system, chances are it will go undetected for too long. With grave effects for the entire world. This is all the more true given the fact that zoonotic events, in which pathogens transfer from animals to humans, are more likely in regions with high biodiversity and frequent interactions between humans and wildlife.

All of this means that it is crucial to ensure Universal Health Coverage around the globe, as promoted by the United Nations. This is an investment in everybody's safety. And of course, given the fact that half of the world's population have no access to the health care they need, it is also a moral imperative to change this situation. Making vaccinations available as soon as possible in all parts of the world would be a first important step.

Dr. Stefan Oschmann Lessons Learned from Covid-19

Pandemic prevention needs collaboration

This already indicates that there is no effective pandemic prevention without collaboration. Indeed, we need to work together across borders and across sectors, on all levels. The Coalition for Epidemic Preparedness Innovation (CEPI) is a prime example: It is an international public-private partnership founded in 2017 to accelerate vaccine development. And it has proven invaluable during the current pandemic. Another vital aspect is that we need to strengthen multilateral organizations, especially the World Health Organization (WHO). There is no better candidate for gathering and spreading information on health emergencies and coordinating countermeasures across the globe. So, we have much to gain by a WHO which is brought to new strength through sufficient funding and state-of-the-art processes.

Not least of all, the pandemic has shown how much we can benefit from investing in research and development. The speed of vaccine development has been a singular feat in human history. Indeed, the mean development timeline for new drugs is usually at nearly ten years. Previously, the fastest vaccine development was that for the mumps virus, which took four years in the 1960s. With Covid-19, we saw the first emergency approvals just 11 months after the sequence of the virus was published. Several aspects came into play to achieve this, from regulatory factors to sharing information readily to extraordinary investment levels in the face of the pandemic. While much of this will not be replicable in non-crisis times, there is reason to believe this experience will have a lasting effect on future drug development.

Science and technology are the key to a good future

And there are many other fields in which we need to advance research and development in order to mitigate the effects of future epidemics. Understanding the pathogens in animal populations can help prepare for possible future zoonotic events. Advancing biotechnology can promote the rapid development of diagnostics, therapies, and vaccines. Artificial intelligence and big data approaches can support the early detection of emerging health crises and efficient tracking of the way they spread.

It would be difficult to find an instance in history when the power of science and technology to improve our lives could be felt so immediately by so many people as during the Covid-19 pandemic. And I believe it is encouraging to see that the trust in science has increased in parts of the world such as Germany. I am deeply convinced that we have much to gain from fostering such a development. After all, scientists will play an all-important role in overcoming the challenges in our future – be it the next pandemic or the effects of climate change. If we manage to organize stronger healthcare systems, promote collaboration, and advance research and development, we have great opportunities create a safer, sustainable, and more livable future for everyone.

“I LIKE TO GO TO NEW EUROPE WHERE I KNOW THAT THE ECONOMIES ARE SET TO GROW.”

In an **interview** with former CNN’s Emerging Markets Editor/Anchor and Stern Stewart Institute Board Member, **John Defterios**, the founder of the real estate company Emaar Properties and e-commerce platform noon.com **Mohamed Alabbar** talk about building Zand in U.A.E., a independent digital bank, as well as about his passion for “New Europe” and his projects there.

Digital-only banks have been on the rise for the past few years. Valued at $20.4 billion in 2019, the industry is expected to jump to $471 billion by 2027. Hoping to take the lead in the Middle East, the United Arab Emirates (UAE) is launching its first fully independent digital bank, Zand, led by Mohamed Alabbar, who is also the founder of real estate company Emaar Properties and e-commerce platform noon.com.

John Defterios (left)
Mohamed Alabbar (right)

John Defterios: So let's start with Zand, Mr. Alabbar. What's the big idea? Is it that digital banking is a new way to be a disruptor, as it can challenge the home-grown players operating in traditional banking? How do you see your big idea?

Mohamed Alabbar: The big idea is that it's the first digital bank in the country. The big idea is that it's the first digital bank that looks after consumers and corporate at the same time. But I believe the bigger idea is that we, who are the people behind the bank, we live the digital life. We have digital businesses. So we come from that mindset and having that mindset is the real big idea, because you can think digitally and that's what makes the difference between a successful digital bank and a successful bank.

J.D.: You've scoped the landscape. Is there an advantage in not having the burden or the legacy of bricks and mortar, which traditional banks have?

M.A.: From our previous experience in our e-commerce businesses, I think if you have no legacy it's so much better because it's a completely different way of thinking. It's a completely different mindset. You need completely different people, because you can't operate a traditional bank and keep it alive while trying to learn digital banking. In my humble views, I think banks will do well. I think they are already doing well, but you can't trigger this thing to be the new life.

J.D.: Do you envisage synergies between your retail platform noon.com and Zand?

M.A.: For digital banks to provide great service with speed and agility, you're going to need many partners because at the end of the day you really have to provide a complete service for your customer digitally. So you'll have your supermarket partners, your e-commerce partners, your food delivery partners… because at the end of the day it's about pooling resources. You pool data, you create a complete service in order to make life comfortable for your customer.

J.D.: What have you learned from noon that you can bring into the digital banking space, as a disruptor?

M.A.: Well, a lot. Number one: that customers are ready for it. And they trust you. Even if you don't have an office and a physical presence, as long as you provide a good service, great technology, good people, and you keep enhancing this all the time at the lowest cost. Because that's so important for them, and it's also been proven that without physical "prisons" you can actually double your business annually – without branches and without headquarters and big buildings and big signs.

It's a completely different mindset. You need completely different people, because you can't operate a traditional bank and keep it alive while trying to learn digital banking.

J.D.: What impact has the pandemic had? Did it trigger the idea or did you have the idea already but it made you say that now is the time because the pandemic has forced us to think differently about working, and banking too?

M.A.: We spoke in the past, John, and I think I told you that I'm just mesmerized by the amount of time we spend on our phones, which is now about six hours a day, I guess. Therefore, life is on the phone. So we started the bank two years ago. But going through all the process of approvals and directives and building the technology has taken us about two years.

J.D.: As you know, because you're a globalist, in the United States, Europe, and Asia, about 70%, 80% of jobs are linked to small and medium-sized enterprises. And I know it's a priority in the UAE to foster this sector. What role will Zand play in that space?

M.A.: I guess that in the UAE we really were late in helping small businesses. But this technology and fintech – and all credit to the fintech partners – will make it so much easier, so much more efficient and cheaper to provide services and funding and products for small businesses.

J.D.: This neobanking sector is extraordinary. It's only worth about $20 billion worldwide now but is expected to grow 20-fold by 2027. We haven't seen anything yet.

M.A.: I guess it's not only the change in banking and this growth that you're talking about. For example, General Motors decided to stop producing normal cars: it will all be electric in a few years. Basically, banking is the only industry that has to move on because its customers have moved on. You think our young people would go to a bank? If it isn't on a screen, they don't know how to deal with it.

J.D.: So when we talk about neobanking, what's the huge advantage for customers? The interface, of course, is one, but can you actually give better prices to smaller businesses and tech startups or offer more competitive personal loans as a result of not having the legacy of a bricks and mortar network?

M.A.: It's a case of 24/7 and again 24/7. But if you need to talk to someone, they're also available for you 24/7, so you're not alone. The other key thing is costs. These new digital banking systems mean no headquarters, not a lot of staff, no branches, no cars. It's pretty simple. You don't even know where the office is. It could be in a warehouse, right? So there's a large amount of savings that you can give back to the customer, either in the form of the interest rate that you charge on a loan or at the deposit level. But more importantly, also, this technology just keeps on improving, in the same way you upgrade your iPhone. That ensures that we really serve you well, because you need change. And one person's needs are different than another person's. The other thing is that if I take all the data – and again, AI is smarter than all of us combined – I can measure your future cashflow needs. And I give you what you need. I can measure your debt capacity, better than any human mind, and I give you that. And that's where the small guy will benefit more than anybody else and at lower cost. But then I can also bring on board a lot of partners to provide you with all the other services you need. I can provide the bank, the banking, I can provide other digital services to make sure that your life is complete and comfortable, and you're still sitting in your pajamas.

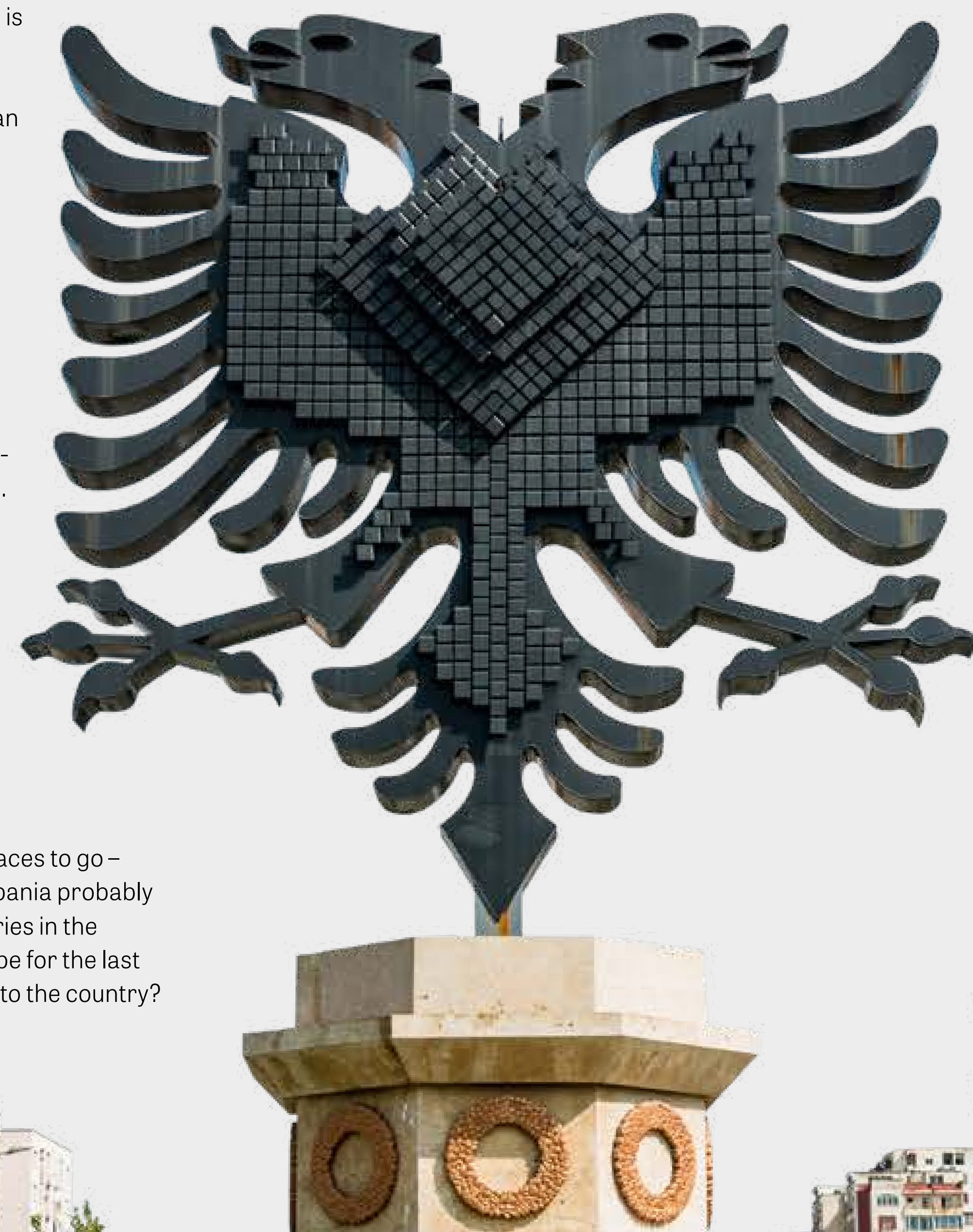
J.D.: Turning now to the Albania project. It's interesting: if you look at the global map of where people want to put their money, in terms of foreign direct investment into countries, Albania wouldn't come top of the list. Is that an advantage to you because it's a good entry point, or what do you see as the great opportunity in Albania?

M.A.: I've been in and out of Albania for the past two years, so I know the country very well. For me to decide to invest, I really have to review the situation carefully, but I really love New Europe. I like to go to New Europe where I know that the economies are set to grow. I know that governments are really working hard to improve the quality of life of their people and encourage investment. So Albania came out top of the list, and I'm also happy about how my relationship with Prime Minister Edi Rama has developed over the past two years. I can really see that these people are working so hard to be part of New Europe. And I thought, wow, this is just a great opportunity for me.

J.D.: It's not a member of the European Union, but it has aspirations to join. So it's that window of opportunity that gives you the greatest potential at this stage, because it's almost a greenfield site in terms of foreign direct investment.

M.A.: Since I've operated in almost 15 countries, it gives me a chance to really measure and understand countries, maybe better than other people. But this is the right time. Okay, they are going for EU membership, but I would like to be the first one in there. And all the indications are that it is the right time to go there. And Albania is in Europe anyway, but some countries are late because of legacy issues in the past. And the country is moving forward.

J.D.: If I was going to pick different places to go – and maybe this is the beauty of it – Albania probably wouldn't be in the top 30 or 50 countries in the world. You've scoped out the landscape for the last couple of years. What's attracted you to the country?



Interview "I Like to Go to New Europe Where I Know that the Economies are Set to Grow."

M.A.: Well, I operate in 14 countries, so I have a good feel for them as well, but when I go to a country and I see how eager the government is to move the country forward and how hard they're working to achieve that…And it will be part of Europe. There's 450 kilometers of amazing coastline, double-digit growth in tourism, a friendly government with Prime Minister Edi Rama and his team working so hard to invite investors and make it easy for you to work in the country. Plus there's the great workforce. I would like to be the first one there.

J.D.: Many people would look and say, "Albania has a reputation for corruption, drug trafficking, human trafficking." That doesn't deter you?

M.A.: Well, you know, we read about history a lot, but the world changed, the world moved forward. And if you see the change that's taking place in the country, how safe it is, the quality of governance, quality of food, quality of government policies…No, unfortunately Albania had issues because of governance in the past, probably before the nineties. And they had to grow out of that. It's not going to happen overnight, but I think they're getting there. And all the indications are really very positive for me. That's why I'm undertaking a sizable project there. And I'm so proud that I'm the first one.

J.D.: Your project is a mixed-use development covering 800,000 square meters, with sizable apartments, hotels, offices – the whole caboodle, as we say. But can this model from the UAE, something you put forward in Dubai, be transferred to a country like Albania?

M.A.: Well, I think I've done that in many countries. The last time was in Serbia, where I had to develop the area around a train station, and I did exactly the same thing. And it worked extremely well. I really believe that this works everywhere in the world, but you have to do it with the right partners. You have to focus on quality, credibility, good consultants, good design, but the market has to be right too. So you can't go wrong, you know, building the largest marina on the Adriatic in Durrës, with over 12,000 apartments, hotels, restaurants, and shopping. For me, it's like, I've got a dream and I'm going to go and realize it.

J.D.: Would you define it as the next Croatia? Because that's had great popularity and growth over the last decade, in particular. We know your experience in Belgrade, but what does Durrës offer that, say, these other destinations don't?

M.A.: The history of Durrës, and all the ruins, just 50 meters from the port, and all the old Roman theaters that are 2,500 or 2,900 years old, and some Ottoman ruins as well in that area – this makes it very unique. You're on the beach, and you're also immersed in history because Durrës was really the gateway to that region, almost 2,500 years ago.

J.D.: Would you say that, as an Emirati, you share a common business DNA with people from Albania, Serbia – the New Europe, as you define it – so that you are comfortable doing business together and can make it work, whereas perhaps others haven't even explored this?

M.A.: It is indeed the case. And the reason is that when you walk around there, you feel it, people are warmer, people are kinder, people are polite. You sense it in any of these countries, but Albania more so, just because they're closer down to us. So I guess that's why I feel comfortable. we're all going to go and do business but if I find people like that, I'm willing to accept a lower rate of return. ◾

Cüneyt Yavuz
CEO
Mavi

Not Just Surviving but Thriving: Reflections on the Past 18 Months

On March 19, 2020, Mavi unilaterally decided to shut down all their operations in Turkey due to rising Covid-19 cases.

The Stern Stewart Institute PERIODICAL #23

The health of our employees and business partners is paramount. We won't resume normal operations until we have a better understanding of how to tackle this new unknown.

We closed all our stores and told our employees to start working from home. This was quickly followed by similar action across all our legal entities, in Germany, the US, Canada, and Russia.

It was a bold call that was reciprocated by key retailers in Turkey, and by that weekend all malls and retail operations were shut down. Note that this action was not taken in response to any government support or guidance. It was a principle-based decision. The key driver was: "The health of our employees and business partners is paramount. We won't resume normal operations until we have a better understanding of how to tackle this new unknown."

Like all good companies, Mavi has solid contingency plans for potential business risks, ranging from what to do in case of a cyberattack to currency-related exposures.

Covid-19 was not on that list.

Of course, we were already talking about the need for new flexible working arrangements, we were investing in our e-com channels and discussing the rise of new market players and what it meant for our business, we were putting more and more emphasis on investing in technology-related areas to make our company smarter and more digitalized. All these strategies were in place, along with our rolling three-year plans. But at the time of our closure, little did we realize that we would be well down the road of our three-year plans in less than a year.

Before delving into anything else, I want to state my top takeaway from this pandemic: **Our number one asset is our people!**

Three guiding principles for success

Every senior leader along their journey acquires certain key success mantras. My trilogy of success is as follows:

Ensure the whole organization works in **full alignment**. Make it crystal clear to every member of the team where we are headed and what success looks like. To achieve alignment, continuous communication and transparency are key. Be bold in aiming high, enable a risk-taking culture, quickly acknowledge mistakes and avoid blame culture. Cherish and accept change as a gift. Make it clear that this will be a restless company, but not a chaotic company. And the key to cementing this full alignment is unwavering constant communication. Signaling where we are versus what we set out to be and how we are doing every day, every week, and every month… Always assuming not everybody is fully on board – because the fact is, not everyone will be. This approach will increase trust in the company. And there is no price tag for trust.

People are our most important resource. We have to recruit, develop, and nurture the best people for the jobs we have.

In this dynamic and competitive business environment, another key competency for success centers around **drive for results**. At any given moment in a company, there are many activities going on. Unfortunately, not all the energy and resources we expend are geared towards the results we set out to deliver. It is part of human nature to do what we like doing and skew towards what we are good at, and at times this can be incongruous with strategic priorities. Therefore, it is vital for leaders to celebrate results and not activities; not to applaud the launch of a new idea or a product but to recognize the results that the launch was intended to achieve (market share, bottom or top line growth, etc.).

Finally, it is all about **building the best team**. People are our most important resource. We have to recruit, develop, and nurture the best people for the jobs we have. Time and again, it is not the individual but the team that wins. Therefore, building the best team is priority number one. "A's hire A's, and B's hire C's." We can't let the organization fall into a B/C trap.

Learning from the pandemic

When I reflect especially on the time between mid-March and June 2020, when we were fully closed, I am proud to say that we were able to adapt to the unexpected business disruption and handle the challenges with a can-do attitude. Over the last 18 months more broadly, the team has rallied together to help Mavi emerge stronger than before. This was not a local challenge. It was a global one, impacting all offices on a more or less similar timeline. It required clear prioritization, clear messaging, and working around the clock to realign many divergent business priorities. At the time of writing (July 2021), our team is looking much stronger, more experienced, and also prouder to be a part of this brand and company than they were in March 2020. All our international markets are above their 2019 levels and growing, our e-commerce business has coped with the unexpected surge in demand without wavering on service quality, and in our domestic market, Turkey, we have further grown our market share in the jeans and casual wear segment.

So the **people** factor is vital. But it is worth noting a few other key lessons from this period.

Brand and market share

We at Mavi are wired to think in volume and units rather than in currency terms. How many new customers have we gained this month? How many more jeans have we sold versus last year? These are questions frequently heard in our meetings. We back our commitment to grow in the categories we compete in and acquire new customers through continued investment (not spending) behind our brand. We have been relentless on this front. Many investors doubted the resilience of retail brands to weather such long periods of closure. At Mavi, we have proven that we have loyal followers, fans, and lovers of what we do. Yes, we lost sales during the closures, but by maintaining and even upping our brand investment, as soon as there were days of even semi-opening, our store sales exceeded our expectations. Today, we have greater market share in all the categories we compete in. And as business normalizes, we are all set to continue building on what has been achieved.

Our marketing team makes us proud by continuously ensuring that our brand is bigger than the company in the hearts and minds of our consumers. And for employees, it's a real morale booster to work in a company that can grow even in times of unexpected disruption such as this pandemic.

Supply chain

Mavi is first and foremost a branded jeans-centric apparel goods retailer. We manufacture our jeans and casual wear predominantly in Turkey, a great textiles country. During the pandemic, many industries experienced varying degrees of disruption in their manufacturing, sourcing, and logistics. For us the disruptions were minimal, and we were even able to further strengthen our already well-established supply chain ecosystem. Over the years, we have consistently prioritized quality, innovation, and speed over cost, and during the pandemic the level of collaboration and coordination with our partners has been outstanding. Our inventory remained fresh thanks to all the systems to optimize speed to shelf. Design, category, and sourcing teams worked closely with our manufacturing partners to deliver great new products that met and exceeded changing consumer demands. And once in stock, our fresh products flew off the shelves. So, I cannot thank our business partners enough. This goes to show how important collaboration and business alignment truly are.

Sustainability

Throughout all the challenges of Covid-19, we have remained unwavering in our commitment to sustainability targets. We are well aware of the responsibility we owe to the precious world we live in and it is now ingrained in our strategies to place sustainability at the forefront of our agenda in everything we do. We are determined to make sure that Mavi continues to excel in what the investment community calls ESG (environmental, social, and governance) measures, and we stand ready to tackle the future business challenges of diminishing world resources.

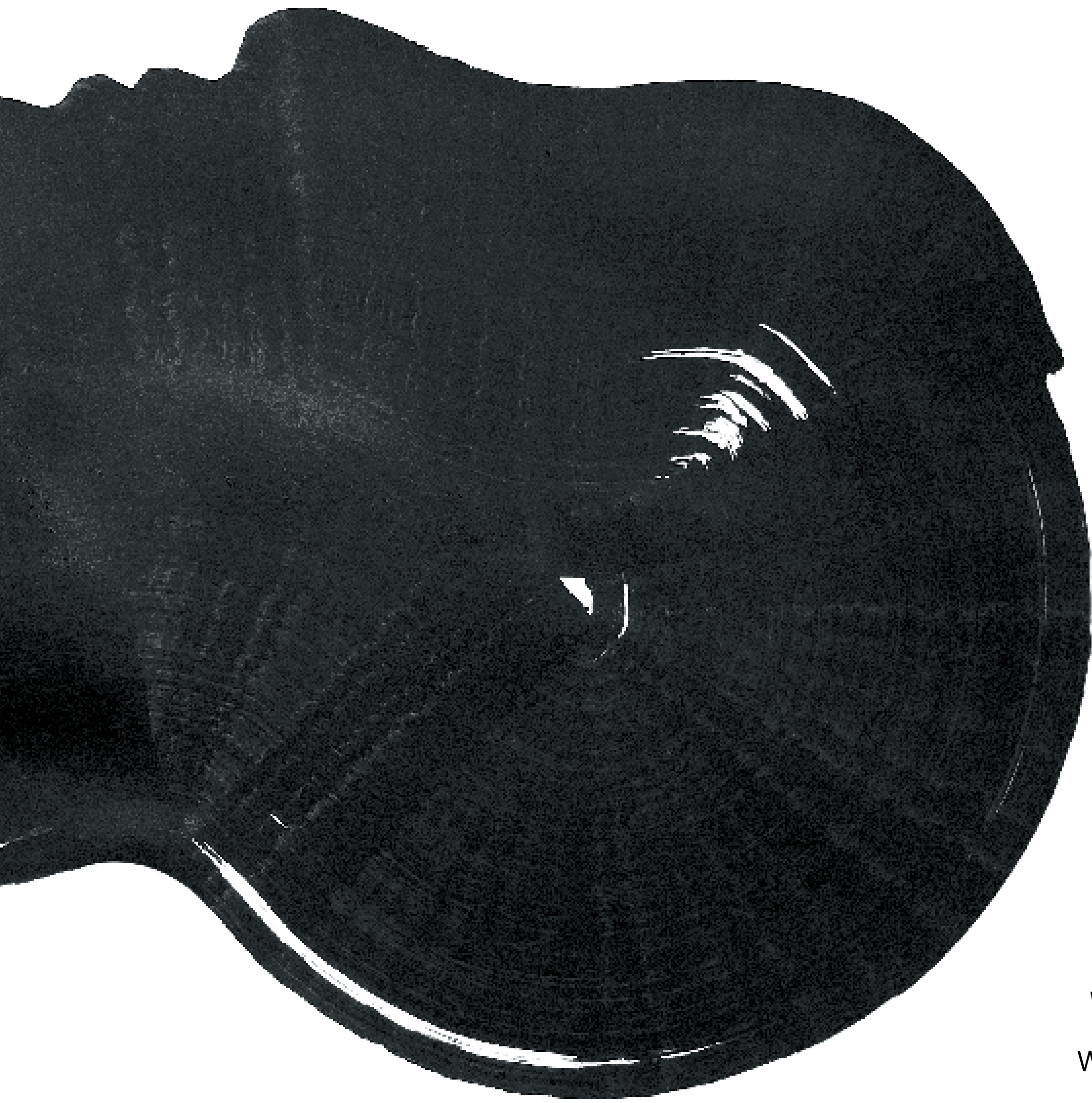
E-commerce and (above all) Digitalization

Our e-com business has quadrupled over this period. More importantly, this growth has been profitable and lucrative for our business. I call Mavi "future-ready" to emphasize our adaptability to the shift to e-commerce in a profitable way. If all our business were in e-commerce, we would be an even more profitable company. However, e-commerce is not and cannot be the sole game changer. It is a must have, yet I believe physical retail is here to stay for a while yet. The holistic shopping experience is going to be key. Even more important, though, is the ongoing digital transformation. While our capabilities in product forecasting, promotion planning, and price optimization are reaching new levels every day, we have further work to do to become a data-driven digital company. We are already a much smarter business than we were 18 months ago and are committed to becoming even smarter through uninterrupted digital investments.

A final reflection

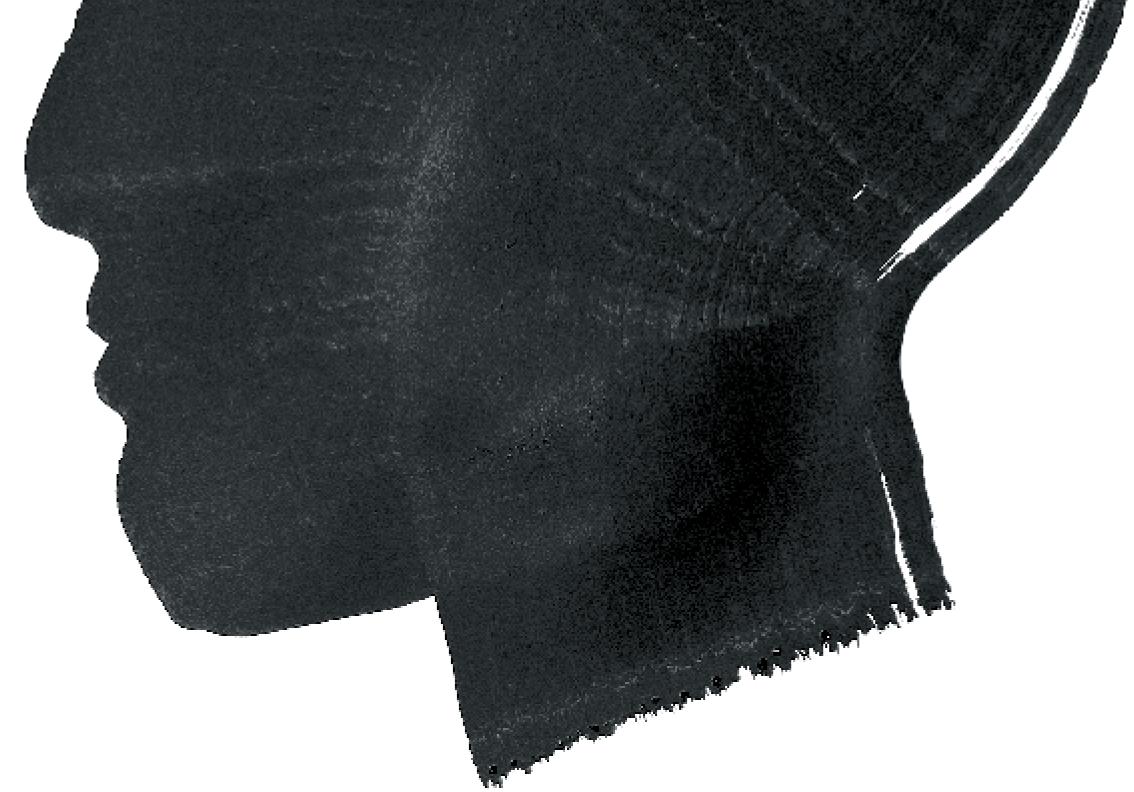
These times have been truly testing. Many of the points outlined above are common reiterations of what makes a good company. As always, the key to success boils down to execution. Walking the talk.

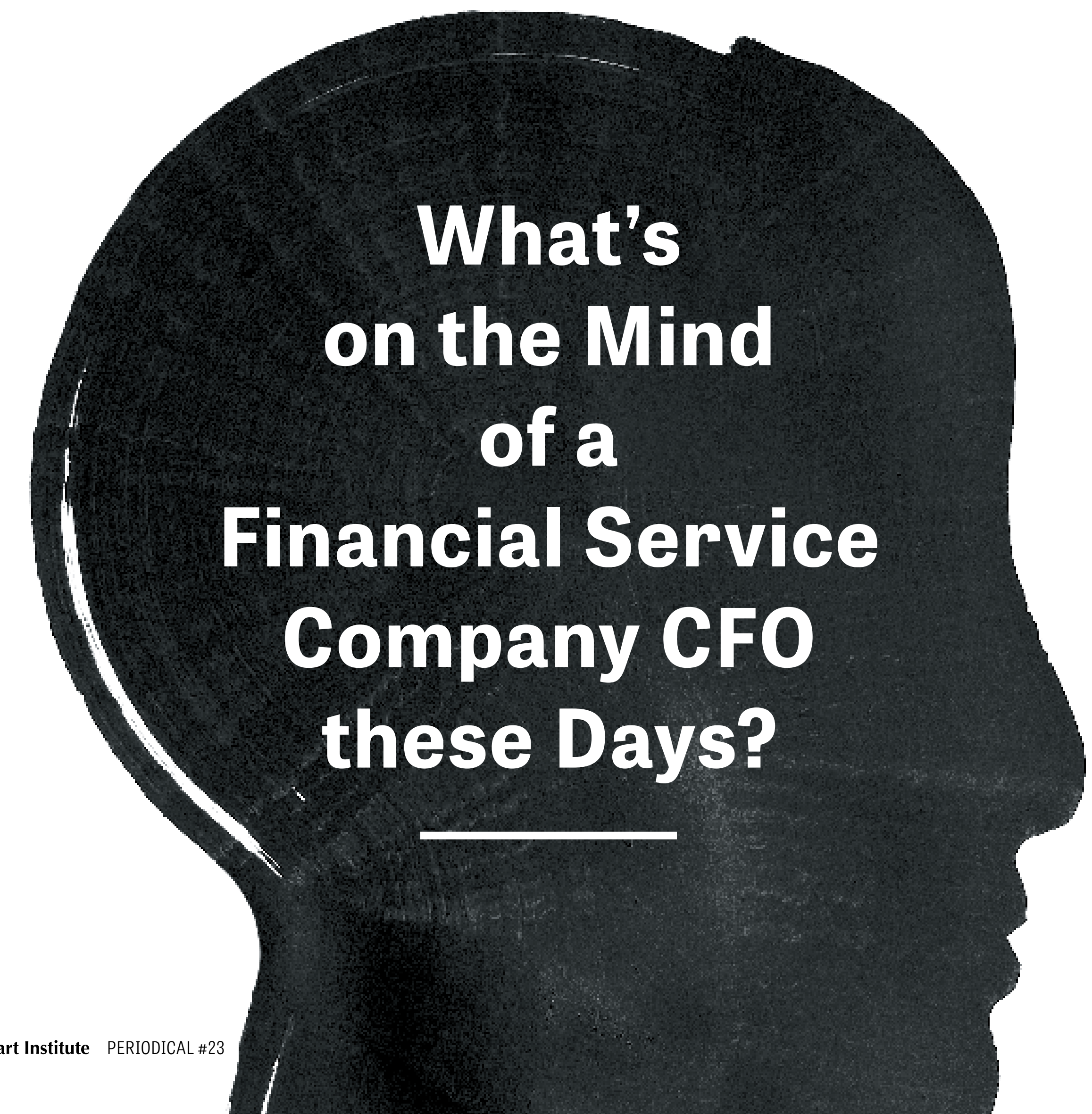
To follow through on great execution, an entity needs well-grounded values, meritocracy, and a clear vision of where it is heading, even if the road ahead is not always clear. Over the past 18 months, some days we have had to manage by the hour, at other times by the week, adapting extremely fast to changing externalities, staying connected to one another and overcommunicating where necessary. Today the road ahead is still not all that clear, but definitely much more visible than a year ago. We have learned to be even more agile and even more adaptable. In these challenging times, we have proved that it is possible for a business not only to survive but to thrive.



We are not yet out of the woods with Covid; there is uncertainty around the economic and capital markets impact, and regulators are cautious in allowing for dividends and especially buybacks.

Giulio Terzariol
CFO
Allianz SE





What's on the Mind of a Financial Service Company CFO these Days?

In times of great uncertainty, it is important to stick to the value drivers you can control. Thus, topics like "delighting your customers" and improving productivity remain front and center. The CFO's role is to keep resources flowing to support the long-term strategy and agenda of the organization. After all, revenue growth and healthy operating margins are key conditions for a resilient financial position.

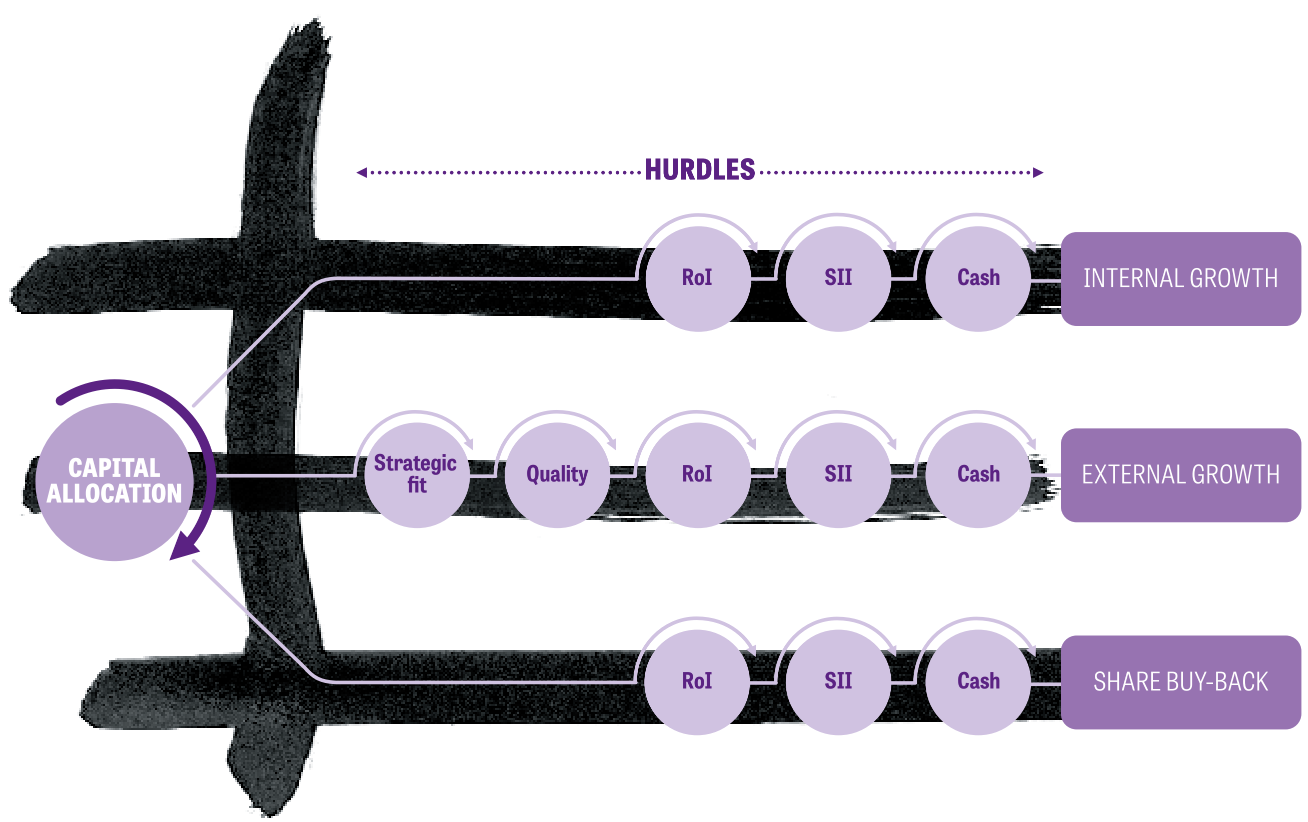
The foundation of a strong balance sheet is a franchise with strong operating performance. Indeed, when rating agencies are assessing two companies with equal leverage and capital, they will base their ratings on the respective operating performance and the ability to generate free operating cash flow. Thus, even in a crisis when more attention is devoted to capitalization levels and capital preservation, the CFO will still place operating performance at the top of the agenda. Clearly the full repertoire of capital management will be also put to use. The capital and risk management practices established during "normal" times are in fact preparing us for the next crisis. Much like an earthquake: we cannot predict when and how the next one will hit, nor how strong it will be, but we can make sure we have built structures resilient enough to withstand it.

Challenge as a chance

Crisis creates challenges, but also brings opportunities. In particular, a crisis usually leads to a wider differentiation between stronger and weaker companies. The latter will have to reassess their footprint and, most likely, dispose of some businesses to strengthen their balance sheet. This is an obvious opportunity for companies with stronger financials to engage in external growth. Indeed building up balance sheet strength during the "good" times is not just a defensive tactic enabling greater resilient in a crisis situation, it is also a strategic choice that creates growth opportunities. Balance sheet strength and a growth strategy go hand in hand – you cannot have one without the other, unless you are looking for a problem down the road.

Deploying capital when uncertainty is high requires prudence, caution and good judgement on business prospects beyond the crisis. Regardless, there are definitely opportunities that can and should be exploited. Over the last 18 months, Allianz has deployed about €4.5 bn in external growth opportunity and also completed a share buyback of about €0.8 bn.

One key question in the room is always how to deploy excess capital: via buybacks or



Giulio Terzariol What's on the Mind of a Financial Service Company CFO these Days?

external growth. As Warren Buffet said, the skill with which managers allocate capital has an enormous impact on a company's enterprise value.

Fundamentally, every company should pursue stronger market positioning. In most cases, this correlates to better operating performance: access to better resources, talent, partnerships, scale effects and more data. Scale combined with technical excellence and financial discipline normally leads to value generation, as does disciplined growth – which should pay off for the goodwill that you put on your balance sheet. As a CEO of a large insurance group said "goodwill is an income producer and an appreciating – not depreciating – asset over time". This is obviously true to the extent that an acquisition contributes to the creation of a stronger franchise.

Conversely, acquisitions can result in substantial write-downs. It is interesting to see how companies taking large write-downs on their goodwill are quick to point out that it is a non-cash item, but as I have heard said: "while goodwill write-offs are non-cash, they indicate horrendous capital allocation!"

The role of the CFO is to establish a rigorous process around capital allocation. At Allianz, we spelled out our M&A philosophy and hurdle rate in our Capital Market Day a few years ago.

We are looking at achieving an IRR above the cost of equity. The spread will be a function of the different opportunities, but usually we are looking at a 2–3%p spread. The payback period also has to be reasonable, we do not want the value to be dependent on the so-called "terminal value".

In particular, a crisis usually leads to a wider differentiation between stronger and weaker companies.

Speed of value generation matters…

The credibility of assumptions made during asset valuation is extremely important. First, the cost of capital should be achievable under even conservative assumptions: achieving the minimum hurdle rate should not be a function of "believing". Second, the expected value generation over the cost of capital should be based on reasonable, grounded assumptions. Set aside beliefs that an opportunity is good because a potential future trend or additional optionality may materialize. Should this additional potential actually materialize, it would lead to a return significantly in excess of the initially targeted return. That should be the icing on the cake – not something you have paid for. By applying this philosophy, the hit ratio (how many opportunities you act on vs. the cases you are investigating) will be relatively small – but this is what financial discipline is about: "if it is too easy, be suspicious".

Another health check to run is how an acquisition performs against a buyback, something that is becoming a "science" in our industry. Most of the time a buyback will look better on the surface than an acquisition. A share buyback gives you strong EPS accretion right away, an acquisition usually takes more time since at the beginning there may be restructuring expenses and on top P-GAAP items that impact the bottom line.

Everything we do has to serve the purpose and strategy of the organization: which is to deliver compelling returns! Strategy can never be a justification for poor return: this is an oxymoron.

Run the numbers, overcome the challenges

A CFO should also keep in mind that the preference of investors is usually for share buybacks. An investor indeed said, "Our preference is for companies to employ cash for buyback because we believe that every stock we own is undervalued". There is definitely a grain of truth in this: the very investors who own your stock expect significant appreciation and a buyback would add to it. This is not because of the signaling effect, but rather because of how financial math works… the signaling effect would be extra. This said, an acquisition can be better than a share buyback: the role of the CFO is to run the numbers and overcome the accounting challenges through proper communication of the effective value generation.

Good M&A activity with credible assumptions at healthy returns is always rewarded by the market. One important point: avoid using the word "strategic" to justify a poor price. Everything we do has to serve the purpose and strategy of the organization: which is to deliver compelling returns! Strategy can never be a justification for poor return: this is an oxymoron.

The bottom line: share buybacks are an "easy" way to create a compelling EPS story. Sometimes share buybacks are even overutilized to mask the absence of a convincing (growth) strategy or a lack of confidence by management in the company's ability to grow profit and cash-flows. But again, if it is too easy, be suspicious. Indeed, if you extend your horizon beyond the next quarter or next year and look a few years down the road, you can better appreciate that share buybacks might not always be the right answer they appear to be at first glance.

Share buybacks are a great instrument in financial discipline, but they cannot be equated to financial discipline itself. If abused, they are indeed the opposite. The important thing is doing what is right for our customers, business partners, employees and shareholders. It is about deciding what will make the organization stronger, healthier and produce sustainable (within a reasonable horizon) value. To sum it up: there should be no preconceived notion of whether M&A is better than share buybacks or vice versa, since if you are unbiased and process information objectively and fairly, the answer will be different for each case. Beware of those in just one camp!

The important thing is doing what is right for our customers, business partners, employees and shareholders.

Between States of Matter – Competition and Cooperation

America is back, but where is Europe?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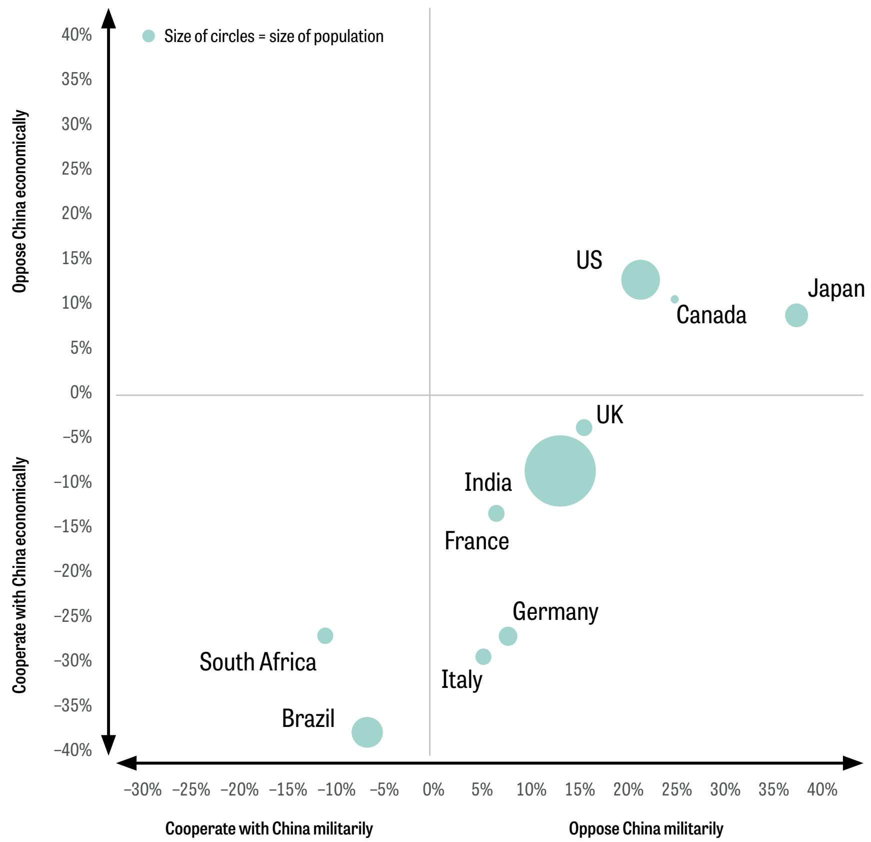
Dr. Benedikt Franke
CEO
Munich Security Conference

Not only did Western countries continue to exhibit a lack of joint action on crucial global issues, the past year also saw continued attacks on liberal-democratic norms in key Western countries, with the storming of the US Capitol as the most emblematic symbol of the threat to democracy.

Earlier this year, the Munich Security Conference presented its annual Munich Security Report. As every year, we have taken pains to summarize and classify the best analyses and arguments of the past year in a way that can serve as a basis for an informed debate on the state of the international system. It also comes with a significant innovation – the first edition of our annual Munich Security Index. Based on exclusive survey data, the index is an annual temperature test of risk perceptions that pervade the societies of G7 and BRICS countries. As this year's conference had to be cancelled due to a pandemic, we have chosen the days before the G7, EU and NATO summits to highlight a key question of our time, namely how liberal democracies can face the many challenges and threats of the coming years.

Transatlantic leaders seem to have come to a common conclusion: the world's liberal democracies are facing a new systemic competition. While they support a joint strategy for dealing with their autocratic challengers by strengthening cooperation with each other, they are only at the beginning of thinking about the best way to compete where they must – and to cooperate with competitors where they can. At last year's Munich Security Conference, world leaders discussed a world shaped by "Westlessness" – as diagnosed by the Munich Security Report 2020. Unfortunately, various developments have vindicated last year's dire analysis. Not only did Western countries continue to exhibit a lack of joint action on crucial global issues, the past year also saw continued attacks on liberal-democratic norms in key Western countries, with the storming of the US Capitol as the most emblematic symbol of the threat to democracy. But there is hope. In the midst of a global pandemic, almost exactly one year after a divisive Munich Security Conference 2020, the speakers at the virtual MSC Special Edition on February 19, 2021, including US President Joe Biden, German Chancellor Angela Merkel, French President Emmanuel Macron, and other world leaders all voiced their support for a new beginning in the transatlantic relationship and for revamping cooperation among liberal democracies to prevail in a new age of systemic competition.



WHAT DO YOU THINK YOUR COUNTRY SHOULD DO IN RESPONSE TO THE RISE OF CHINA AS A MILITARY AND ECONOMIC POWER?

Figure 1: Citizens' preference for their country's response to the rise of China, share saying that their country should oppose China minus share saying that their country should cooperate with China, 2021, percent

Data and illustrations:
Kekst CNC, commissioned by the Munich Security Conference

USA is back, what role has Europe?

After what can be called an "autocratic decade," liberal democracies are now willing to push back to turn the "illiberal tide." President Biden, having declared that "America is back" and ready to lead, is stressing at every opportunity that democracies find themselves at an inflection point and need to prove that democracy is not a phase-out model but can deliver tangible benefits to the people. While the United States, under President Biden, is bent on taking up its traditional role as "leader of the free world," a return to the status quo ante is not on the cards for the transatlantic partnership. Judging from their rhetoric, European leaders seem to have gotten the message, as few foreign policy speeches fail to mention the need for Europe to take on more responsibility. Yet in terms of action, critics are irritated by a general lack of European proposals to tackle the items on a long transatlantic to-do list. Some already fear that Europe is missing another opportunity to resurrect the West. America is back, but where is Europe? After all, Europe has a key role to play. A shifting balance of power means that the US today does not need followers it has to protect. Rather, it needs capable allies with whom it can work together. As Europe will remain unable to provide for its own security for many years to come, it needs the United States as a "European power." Yet, for obvious reasons, the US will focus its attention on the Pacific theater. Europeans and Americans need to find a new transatlantic bargain that works for both sides. Above all, as French President Macron argued at the MSC Special Edition, this will require Europeans to assume much greater agency at their own doorsteps: "We need more Europe to deal with our neighborhood." Yet it is precisely in its immediate neighborhood where the EU's desire to become more capable and autonomous most frequently clashes with reality. From the Maghreb to the Caucasus, the EU has shown a limited ability to assume a more proactive role and effectively protect its own vital interests. With Europeans being no more than bystanders in some of the gravest crises in their neighborhood, Eastern Europe, the Middle East, and North Africa have become prime examples of "Westlessness." Other powers have exploited this vacuum, pursuing interests that often run counter to those of the EU. In order to become a stabilizing force in its surroundings, Europe still has to tackle major deficits in the areas of capacity, strategic direction, and unity.

	Canada	Italy	Finland	France	Germany	UK	US	Norway	Greece	Japan	South Africa	Poland	Brazil	Argentina	India	Mexico	Hungary	Peru	Estonia	Taiwan	Israel	South Korea	Ukraine	Belarus	Venezuela	Colombia	Turkey	Saudi Arabia	Pakistan	Russia	China	Iran	North Korea
Canada		42	41	41	40	46	40	41	36	35	27	33	22	26	23	34	28	24	18	24	17	27	20	10	4	12	8	−14	−3	−27	−32	−31	−41
Germany	39	39	38	42		29	27	40	34	25	10	22	1	9	6	7	11	6	26	6	14	12	8	−14	−7	−5	−21	−24	−21	−20	−27	−38	−39
France	54	56	52		54	40	45	50	46	32	25	31	18	23	16	21	28	26	30	17	19	23	16	−1	7	11	−31	−16	−23	−7	−18	−34	−36
Italy	39		32	33	34	32	38	35	34	30	15	23	20	23	5	15	19	16	21	9	19	15	12	8	9	6	−12	−5	−15	14	−1	−22	−21
Japan	37	39	34	34	34	36	42	28	22		14	25	22	18	25	17	16	18	16	47	1	−24	11	10	11	7	27	14	3	−29	−42	−9	−49
UK	49	46	48	39	43		43	48	44	36	33	41	23	10	28	26	34	25	30	23	17	24	21	14	12	9	13	−1	5	−27	−28	−31	−41
US	41	36	36	35	32	38		36	35	30	25	29	17	19	20	22	20	20	13	25	26	28	13	10	−2	7	7	−3	−7	−25	−28	−30	−31
Brazil	18	18	3	4	7	15	29	3	5	17	9	−2		14	4	12	−4	12	−11	−11	10	−2	−11	−14	−16	6	−9	−9	−24	−7	−4	−25	−26
China	2	21	19	18	23	1	−16	17	24	−2	31	19	25	27	−10	24	20	21	20		13	8	24	34	29	19	17	24	44	43		26	31
India	30	32	29	32	29	35	32	25	27	30	31	29	29	27		26	24	25	21	23	27	20	27	25	23	29	17	25	−2	30	1	19	12
Russia	−15	11	9	−6	−2	−34	−53	−5	19	−13	14	−37	23	22	35	19	8	19	−32	16	4	4	−53	52	30	9	−9	−6	−12		20	−1	10
South Africa	21	21	17	17	24	29	32	17	13	14		10	26	21	29	14	13	15	3	14	13	11	5	13	15	10	18	14	4	12	14	−1	−3

−60 to −51 · −50 to −41 · −40 to −31 · −30 to −21 · −20 to −11 · −10 to −1 · 0 to 10 · 11 to 20 · 21 to 30 · 31 to 40 · 41 to 50 · 51 to 60

FOR EACH COUNTRY/JURISDICTION PLEASE SAY WHETHER YOU THINK THEY POSE A THREAT OR ARE AN ALLY TO YOUR COUNTRY OR NEITHER.

Figure 2: Citizens' perceptions of other countries, share saying country is an ally minus share saying country is a threat, 2021, percent

Data and illustrations:
Kekst CNC, commissioned by the Munich Security Conference

With Europeans being no more than bystanders in some of the gravest crises in their neighborhood, Eastern Europe, the Middle East, and North Africa have become prime examples of "Westlessness." Other powers have exploited this vacuum, pursuing interests that often run counter to those of the EU.

Dr. Benedikt Franke Between States of Matter – Competition and Cooperation

To effectively tackle the most serious security challenges, the transatlantic partners must learn to navigate between these two "states of matter." Together with like-minded states, they need to seek the right balance: between competing against the illiberal tide where they must and cooperating with challengers where they can.

Balance is crucial

But competition does not have to be all bad. In fact, competition and cooperation do not only coexist. They condition each other. In the case of climate change, for instance, it could even inspire a race to the top, if managed properly – spurring green investments and boosting bold climate action. Whether states will be able to compete successfully will depend on their cooperative relationships with others. Likewise, the way competition unfolds will shape multilateral cooperation, its form, and its formats. To effectively tackle the most serious security challenges, the transatlantic partners must learn to navigate between these two "states of matter." Together with like-minded states, they need to seek the right balance: between competing against the illiberal tide where they must (to defend core values and interests) and cooperating with challengers where they can (to tackle shared risks and threats).

But this is easier said than done. Moving in between these two states of matter, agreeing on, and successfully communicating where and when to cooperate, where and when to compete, or where and when to do both at the same time is no small feat. Against the background of new levels of interdependence and the internationalization of almost all policy fields, such a strategy requires skillful statecraft, intellectual commitment, and appropriate decision-making structures on the domestic and the international level. The necessary debate about how to create these conditions and about how to design, communicate, and implement such a grand strategy has only just begun. We at MSC will continue to monitor and drive this debate.

Dr. Benedikt Franke is the CEO of the Munich Security Conference. This article is based on the Executive Summary of the Munich Security Report 2021 by Tobias Bunde, Sophie Eisentraut et al. The report is available on the MSC website.

John B. Emerson
US Ambassador to Germany
(2013–17)

Gerhard Nenning
Executive Director
The Stern Stewart Institute

In an **interview** with our Chief Editor **Gerhard Nenning** Ambassador **John B. Emerson** talks about the divided American nation, the difficulties in the US political system and the transatlantic relationship.

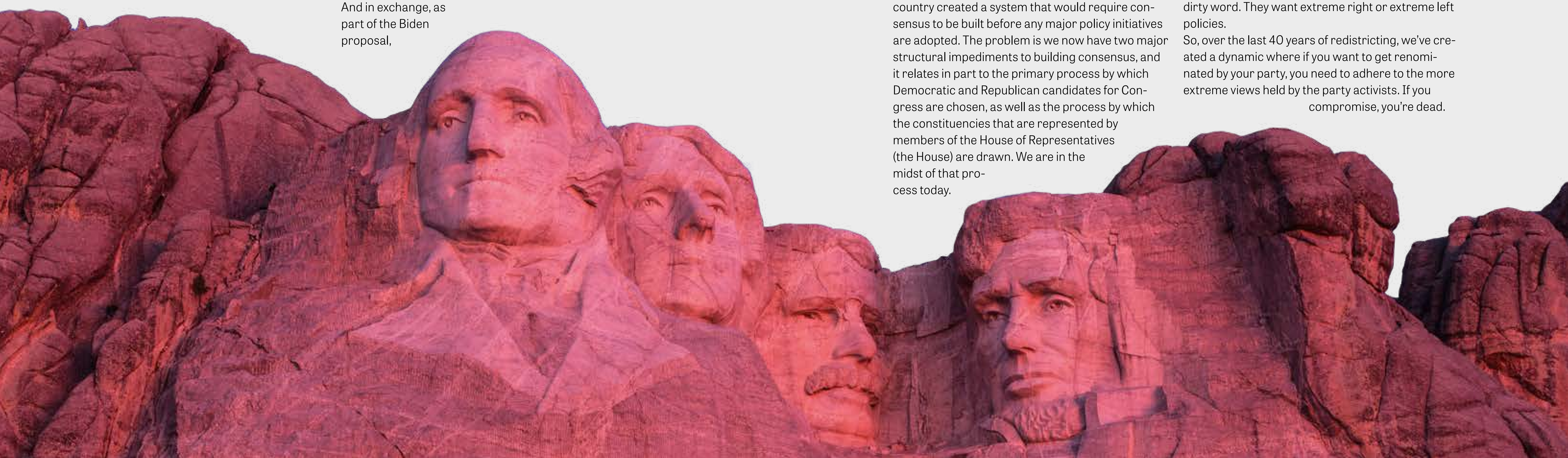
Gerhard Nenning: John, is it fair to say that the United States is more divided than ever? What's the status of the pursuit of happiness?

John B. Emerson: As to your first question, don't forget – in the 1800's we had a civil war! That being said, we in the United States, and indeed the West, face an epistemological challenge where people no longer agree on basic facts. This has led to a division in our society that is very difficult to bridge. Regarding your second question, the "pursuit of happiness" is one of the most unusual, and wonderful, aspirational goals for any nation in world history. In the American system, the pursuit of happiness can best be realized through equality of opportunity. I think that the American dream exists today for many, perhaps even a majority, of the people who live in the United States; yet it doesn't exist for many others. There are many reasons for this, but one example is a dramatic imbalance in the quality of education. Depending on where one lives, or the financial resources they have available to them, there are vast differences in education and employment opportunities, and thus in the ability of people to take advantage of much of what the US has to offer.

G.N.: So if addressing inequality is a big issue, how do you view the economic policy of the Biden administration, which many see as following the European model of a social-democratic approach?

J.E.: First of all, I wouldn't characterize what Biden is proposing as a social-democratic approach. He won the Democratic nomination against Bernie Sanders and Elizabeth Warren by running to the right of such policies. For instance, he strongly opposed the idea of a wealth tax. That being said, what he does believe is that for those who are doing very, very well, which he defines as people who make over $1 million a year, profits from capital investments should be taxed at the same rate as working-class wages. This would result in a doubling of the capital gains tax for such earners. There is certainly push back in Congress to that proposal, from some who are concerned about disincentivizing capital investment, especially as we are trying to grow out of a recession. But it is likely there will be some increase in the capital gains tax for the highest income earners. And in exchange, as part of the Biden proposal,

Depending on where one lives, or the financial resources they have available to them, there are vast differences in education and employment opportunities, and thus in the ability of people to take advantage of much of what the US has to offer.



Interview "We Have a Pretty Dysfunctional System Right Now"

people who make under $75,000 a year would receive a permanent child tax credit of roughly $3,000 per child, and the ability to access two years of free preschool education as well as two years of free community college after high school. This would all help to address the equality of opportunity imbalance we see in our country.

G.N.: In a political arena where any decision has to find a majority, how functional would you say the US political system is right now?

J.E.: Not too good. When observing the 2013 German federal elections as Ambassador, I was struck by the process of coalition negotiations: you have an election, the parties get together to create a government and negotiate broad agreements on policy matters, and then because the government represents more than 50% of the legislature, those policies are enacted. In the US system, where the executive branch is separate from the legislature, we have an election, and still keep fighting about policy positions! And under situations where there is a closely divided Congress, or where either the House or the Senate is led by a different party from the President, gridlock can ensue. I would say that apart from some clear exceptions we have a pretty dysfunctional system right now.
Of course all this is by design. The founders of our country created a system that would require consensus to be built before any major policy initiatives are adopted. The problem is we now have two major structural impediments to building consensus, and it relates in part to the primary process by which Democratic and Republican candidates for Congress are chosen, as well as the process by which the constituencies that are represented by members of the House of Representatives (the House) are drawn. We are in the midst of that process today.

House constituencies are redrawn every 10 years, after we take our decennial census. The number of seats in the House of Representatives is 435, even if the population of the US grows. Some states gain and some lose congressional seats depending on population shifts. And then every state has to "re-draw" its Congressional districts to make sure each constituency has close to an equal number of people. So why does this system create a structural gridlock?
Because, in almost every state, these district lines are drawn by politicians – the state legislators – and the objective of most politicians is to stay in office. So typically, regardless of whether it's the Republicans or the Democrats in charge of a state legislature, they will draw these lines to make their own seats safer, so that it's more likely that the Democratic or Republican incumbent will be re-elected. The problem is their seats aren't necessarily "safe", because a likely Democratic or Republican seat just moves the true campaign battle to the primary election, where the fight is between a Republican and a Republican, or a Democrat and a Democrat.

G.N.: What's the problem with it?

J.E.: Our primary elections tend to have a very low turnout, and are therefore dominated by the activists in each party. For these people compromise is a dirty word. They want extreme right or extreme left policies.
So, over the last 40 years of redistricting, we've created a dynamic where if you want to get renominated by your party, you need to adhere to the more extreme views held by the party activists. If you compromise, you're dead.

That means there are fewer and fewer issues where Democrats and Republicans can work together, whereas if you talk to most voters, on many of these issues they'd like to see people work together.
Structural problem number two is in the rules of the Senate. As you know, we have 100 senators, and today they are split evenly between the Democrats and the Republicans. Normally, if there is a 50:50 tie, the Vice President casts the deciding vote. That's what we have now with Kamala Harris. In that situation, you would think that President Biden could get his legislative program through the Senate. But no, because under the Senate rules there is this thing called the "filibuster," where any senator can place a hold on a piece of legislation and prevent it from coming to the floor. And the only way to force a vote on a piece of legislation is to have 60 votes, the amount required to "break the filibuster." So to get anything done in the Senate you have to have a supermajority – 60 votes out of 100. Well, we have a 50:50 Senate now, so it's very, very unlikely that they're going to get many things done, especially as many Republican senators are concerned about losing to a Donald Trump acolyte in their primary campaigns.

If you compromise, you're dead. That means there are fewer and fewer issues where Democrats and Republicans can work together, whereas if you talk to most voters, on many of these issues they'd like to see people work together.

There is one exception to this filibuster rule, and this is how Biden was able to get his $1.9 trillion Covid relief package through the Senate earlier this year. It's called the budget reconciliation process. Basically, if you have a budget resolution, all the taxing and spending items that make up that budget can be approved in the Senate by a simple majority vote. In this case, with the 50:50 Senate, you have to get all 50 Democratic senators to agree. But on issues like climate change or voting rights or guns, this process is not available and 60 votes would be needed.

You could argue that this kind of dysfunction is what the founders envisioned.

These two structural issues make it less likely that we're going to see compromise, and more likely that we're going to continue to see partisan gridlock. So I would say, from that standpoint, this system, at least in the way our Congress works, has gotten worse.

G.N.: You mentioned the economic stimulus program. What is it about? If I'm right, it totals $9 trillion, between 20 and 25% of GDP. Do you think this is the right approach?

J.E.: First of all, let's clarify our terms. We've had $6 trillion in Covid related spending – $4 trillion in 2020 and then $1.9 trillion that Biden was just able to get through Congress. This was money to keep the economy from falling into a Depression.
The $4 trillion in new spending that Biden is proposing now is true economic stimulus: infrastructure spending and investing in the programs helping working families, to be spent over the next eight years. Biden proposes that these expenditures would be paid for with a combination of new debt and increased taxes on corporations and the wealthiest Americans.
Some people are concerned that the $6 trillion in Covid relief, plus the portion of Biden's proposed economic stimulus that will be financed by deficit spending, is adding too much to government debt. The counter argument is to point out that today, money is really, really cheap. Moreover, the Federal Reserve Bank has promised to keep interest rates down, even in the face of slightly rising inflation.
The view of many is that over time we will grow our way out of this deficit spending, just as we did in the 1990s. Since American politicians are largely reluctant to take the tough steps (tax hikes or spending cuts) required to effectively address accumulating debt, I don't anticipate that there will be any genuine focus on debt reduction for quite some time.

G.N.: Do you think that the stimulus part of the package will take the US into an industrial boom?

J.E.: There are three key areas of Biden's stimulus proposals. The first one is bricks-and-mortar infrastructure spending – money for buildings, roads, bridges, airport expansions, light-rail systems, port and harbor expansions. Biden has also proposed billions of dollars for broadband expansion, and this is a big issue in rural America. Rural America is largely red-state America, so this feature should help to attract bipartisan support.
Much of that, I think, is very likely to get through Congress, adding close to $1 trillion of additional stimulus spending.
The second part of the package, which I think is more interesting in terms of the question you just asked, is Biden's proposal to spend several hundred billion dollars for basic research and investment in technology, and in particular green technology, artificial intelligence, and quantum computing. These are items that he and his advisers believe are necessary to maintain America's leadership in the world, particularly in relation to China.
The third piece represents an expanded definition of "infrastructure spending," to include things like two years of free preschool, two years of free community college, expanded healthcare availability, paid medical and family leave, etc. Biden characterizes this additional $2 trillion in proposals as a one-time "capital investment in the American people." The Republicans call it a wish list of liberal social programs. So that package will only get through Congress through the budget reconciliation process, if at all. If a majority of his proposals are enacted, they should have a significantly stimulative impact on the US economy.

The Republicans call it a wish list of liberal social programs.

G.N.: A program to renew US energy infrastructure and sources would hit the oil industry. How successful do you think Biden will be here, given that oil is a potential issue for Republicans?

J.E.: There is no question that any climate related legislation will not gain support from Republicans in Congress. Regardless, there are steps the Executive Branch can take, and the Biden administration wants to engage in an “all-of-government” approach to addressing climate change. Just as the Trump administration loosened environmental rules and regulations as they apply to big oil through regulations and executive orders, the Biden administration will reinstitute many of those. So we will undoubtedly see a return to some of the Obama-era regulations on energy consumption and the use of fossil fuels.
What may be a more important dynamic is the increasingly powerful concept of ESG investing, which is being adopted by EU regulators, big pension and sovereign wealth funds, and even small investors. This movement from the investment public to invest capital in companies that take ESG into account puts enormous pressure on the fossil fuel industry, for instance, to transform. Investors are better off to be engaged with a company that is transforming rather than to simply divest, as others advocate.

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And it’s interesting to see how this is developing. Take Royal Dutch Shell, for instance. They’re talking about adopting a plan that will be transformative in terms of moving them into non-fossil-fuel based energy production. So it’s not just the Biden administration or the Paris climate change agreement or EU regulators that will move the needle on climate change. Regulatory measures will have a fraction of the impact that the global investment world can have in bringing pressure to bear through ESG investing.

G.N.: The EU, and especially Germany, still proceeds to deepen trade ties with China, despite US concerns. Can there be any alignment given that China is one of the key markets for trade?

J.E.: Absolutely. I don’t think the US is saying to Europe or to Germany, “Don’t do any business with China.” We have many companies that continue to work with China. What the US is saying is that, in the short, medium and long term, American and European firms are ultimately being disadvantaged in doing business with China to the extent that China doesn’t comply with the rules-based order when it comes to trade, intellectual property protection, and forced technology transfers. I have spoken with the leaders of many German and American companies who have had their businesses badly harmed by such conduct. Notwithstanding this, rather than never trading with China, what we ought to do is work together to reform multilateral institutions like the WTO so that they have sufficient enforcement mechanisms to make sure that everybody plays by the same rules. And when there are egregious violations, such as the dumping of low-cost steel on global markets, which hurts both German and American firms, we ought to work together and use our combined economic clout to pressure China to follow the rules the rest of us are following. Now China would like to divide Europe (and especially Germany) from the US. This is because our collective clout is far more powerful in enabling us to effectively compete with China where we should, and challenge China where we must.
It is important for Europe, and Germany, not to fall into the divide and conquer trap.
I do think that one of the great geopolitical mistakes of the last five years was the US walking away – as we did under the Trump administration – from the Trans-Pacific

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Partnership Agreement (TPP), which was a very strong free trade agreement with high environmental, labor, and enforcement standards. If we had gone forward with TPP, creating that huge free-trade zone, we could have then invited Europe to join in. And then China – in which case China would have been compelled to adopt and comply with those high standards. Unfortunately, that was not to be, and China has greater flexibility today to impose its will on its trading partners.

G.N.: So you don’t believe in the theory that there are two blocks, and the rest of the world has to decide which one to join?

J.E.: No. I think that to put companies, and countries, that have supply chain and other economic relationships with China in that binary position does not lead to success in the long term. I think a much better way is to look at the areas where we in the transatlantic community have shared values, where we can work together in our collective interest, to protect our values based, rules based system.

G.N.: So, as a close friend of Germany, how would you recommend that Germany positions itself in that playing field?

J.E.: I think that some of the policies that Germany is adopting, such as restricting countries or their surrogates from acquiring controlling shares in German companies, particularly technology companies, are good. I would encourage more direct communication and coordination with the US when it comes to our overall policy on China. And on Russia for that matter. Unfortunately transatlantic collaboration faltered during the Trump years, but as we saw during the recent G-7, NATO and EU summits, President Biden has clearly sought to re-establish the collaboration we saw during the 40 years pre-Trump.
There will continue to be some areas where we disagree. But I think there is much we can do together, including working within the framework of multi-lateral institutions and bi-laterally.

G.N.: You are still a diplomat at heart.
Thank you very much for the interview.

About this publication

The periodical of The Stern Stewart Institute

23rd Edition, August 2021
Published half-yearly

Publisher and Chief Editor
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Board of The Stern Stewart Institute
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