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MAKING GERMAN FOREIGN POLICY FIT FOR PURPOSE

Geo-Economics and Trade

Germany Must Support Open Global Trade

By Claudia Schmucker

Given how closely the German economy is intertwined with international trade, it is in Germany's strategic interest to support open, rules-based global trade. Germany must therefore also be a strong advocate within the EU for reform of the World Trade Organization (WTO). At the same time, Germany and the EU need to hold their own in a geo-economic trading environment. The key to achieving this, besides reform of European trade policy, is a close transatlantic partnership and the establishment of fair trade relations with China. In addition, free trade agreements with strategic partners such as Canada, including the EU-Canada Comprehensive Economic and Trade Agreement (CETA), must be implemented. The Bundestag should ratify CETA as quickly as possible, as it is one of the EU's most sustainable trade agreements. Germany should also support the establishment of a climate club.

Open, Rules-Based Global Trade is in Germany's Strategic Interest

According to the WTO, Germany ranked third in 2019 – behind the United States and China – among the world's leading [trading nations](#) (measured by exports and imports of goods and services). The trade-to-GDP ratio for goods and services was 81.8 percent in 2020, a high level for a large [economy like Germany](#). Around 12 million jobs depend directly or indirectly on foreign trade.

Given the importance of trade to Germany and how internationally interconnected the country is as a result, Germany is highly dependent on transparent, rules-based global trade that guarantees the frictionless movement of goods and services. At the

same time, being so closely integrated into the global trade system means that Germany is particularly affected by crises in the system.

For this reason, it is problematic for Germany that the **WTO**, the guardian of rules-based world trade, is facing fundamental challenges: Its rules are outdated (dating back to 1995) and do not reflect the realities of global trade in the 21st century. The WTO's ability to settle disputes between its members via a transparent, rules-based process has also been blocked since December 2019 due to the refusal of the United States to appoint new members to the Appellate Body.

Furthermore, Germany's relations with its most important trading partners – the United States and China – are

troubled. In 2020, as in previous years, the **United States** was the most important buyer of German goods, ahead of [China](#), importing goods worth €103.8 billion from Germany. For its part, Germany was the biggest foreign investor in the United States in 2020, according to the US Bureau of Economic Analysis. Nonetheless, there are still transatlantic trade conflicts dating from Donald Trump's time in office. Relations must therefore be improved under President Joe Biden.

China, meanwhile, was Germany's most important [trading partner](#) in 2020 for the fifth year running; according to Germany's Federal Statistical Office; trade in goods (exports and imports) between the two countries was worth €212.7 billion. At the same time, however, Germany suffers from

high market access barriers, opaque subsidies, and problems such as forced technology transfer on the Chinese side. It is therefore in Germany's (and the EU's) strategic and economic interest to establish rules-based and fair trade relations with China.

Trade Figures 2020

(Exports/Imports in Billion Euros)

103.8

German Goods → USA

67.7

Germany ← US Goods

95.9

German Goods → China

117.0

Germany ← Chinese Goods

Source: Federal Statistical Office (Destatis)

The **EU** also needs to reposition itself in the current geo-economic environment so that it can better assert its interests and protect its standards and values. This includes realigning European trade policy to foster greater assertiveness and implementing and ratifying a broad network of ambitious free trade agreements (FTAs). To address public concern about free trade agreements, German policy will need to not only focus on the economic and strategic advantages of FTAs but also give greater consideration to climate and environmental issues.

DETERMINING FACTORS

Weaknesses and Strategies

The **WTO** is currently experiencing its deepest crisis since its creation, af-

fecting trade liberalization and the modernization of its rules, its dispute settlement function, and trade policy monitoring. The Doha Round, which began in November 2001, stalled in 2008 and has still not recovered. In December 2001, China joined the WTO, which gave an important boost to global trade. However, the current lack of progress on international trade negotiations and two decades of tensions surrounding China's WTO membership are raising fundamental questions about the credibility and future of the WTO.

The WTO's weakness is the backdrop to the growing geo-economic rivalry between the economic powers of the **United States** and China. In recent years, the WTO's credibility has been undermined by the "America First" approach adopted by Donald Trump's administration, which viewed international economic and trade relations as a zero-sum game in which the United States could gain only if others lost out. Trump consequently blocked the WTO's international dispute settlement mechanism and began to place economic and political pressure on trading partners and allies, such as the EU, to induce them to open their markets to American products. Although there are signs of a return to multilateralism under the Biden administration, many of the WTO's problems will not be resolved in the foreseeable future.

In addition, **China** has long made use of geo-economic approaches in its economic policy. For example, Beijing is using the Belt and Road Initiative (BRI) to seek to open new markets, create coercive economic dependencies, and enforce Chinese technological standards and norms across Eurasia. Market-distorting measures in China also have a negative impact on the EU's trade and investment relations.

This increasingly conflictual geo-economic trading environment has led the

EU to embark on a reform of its trade policy, with the aim of remaining an assertive global player despite these new conditions. In February 2021, the European Commission published its new trade strategy entitled "An Open, Sustainable, and Assertive Trade Policy." It listed six areas that it regards as critical to the EU's trade policy: WTO reform, the green transition, digital transformation, the strengthening of the EU's regulatory impact, the strengthening of the EU Neighborhood Policy and deepening of relations with Africa, and a greater focus on enforcement.

To this end, the EU plans to strengthen its partnerships with allies such as the United States within the framework of its "open strategic autonomy," with the aim of working together to address global problems; at the same time, it will seek to strengthen trade with difficult partners such as China by developing new trade tools and more effective enforcement mechanisms.

CHALLENGES

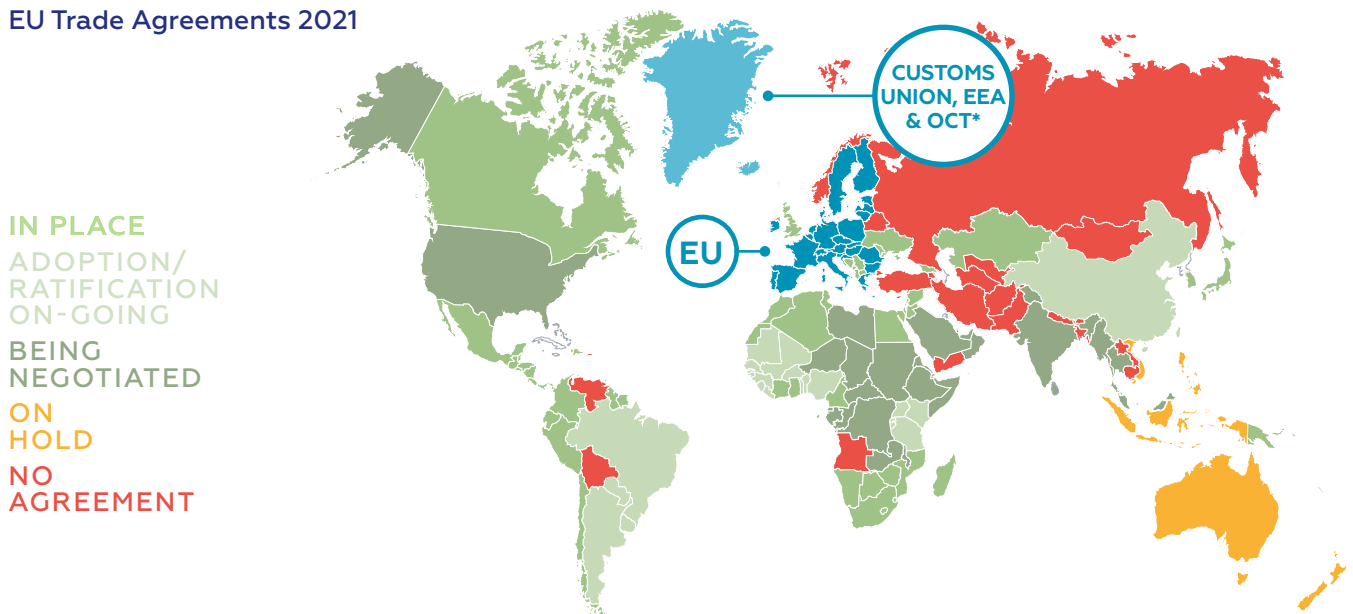
The WTO in Crisis

It is in the strategic interest of Germany and the EU to safeguard the rules-based global trading system. The EU and Germany are actively working on reforms of the WTO; however, they have been unable to implement their proposals so far, due to the lack of cooperation from the previous US administration and China's refusal to take responsibility for the world trading system.

Realignment of Trade Relations with the United States and China

Germany and the EU need to adapt to the changes in the geo-economic trading environment in order to minimize the negative implications for their trade and investment relations. If they are to set global standards and shape globalization, they

EU Trade Agreements 2021



*European Economic Area and Overseas Countries and Territories

Source: [European Commission](#)

need the transatlantic partnership with the **United States**. The Trade and Technology Council agreed upon in June was an important step. However, further initiatives are also needed for a positive trade agenda with the United States, focusing primarily on closer coordination on export controls and investment screening, and cooperation on cybersecurity and cyber-theft.

The EU lacks a coherent trade and investment policy in relation to **China**. Although the prevailing image of China is continuing to change in Germany – a process accelerated by the election campaign – and in the EU more widely, the EU member states still have differing risk perceptions. Italy, for example, has joined the BRI; countries in Central and Eastern Europe are working with China in the 17 plus 1 format; and Hungary and Greece are blocking common European positions. Germany must therefore do more in future to bring about common European positions and, in this context, ensure that economic issues are more closely linked with environmental protection, human rights, and security issues (5G/6G).

Lack of Ratification and Unenforceable Chapters on Sustainable Development

The EU has a near global network of free trade agreements that promote rules-based trade with strategic partners. That said, many agreements, such as CETA, are applied only on a provisional basis after ratification by the European Parliament and require further ratification by the member states. Germany has not yet ratified CETA. Trade issues are also being linked to climate and environmental issues to a growing extent. Precisely for that reason, the existing chapters on sustainable development in the agreements must be strengthened and made enforceable, partly in response to public concern on this issue. The new Bundestag should position itself accordingly.

The Carbon Border Adjustment Mechanism as a Source of Conflict

The EU is seeking to make its economic policy more sustainable, in line with the European Green Deal. In July 2021, it therefore proposed introducing a Carbon Border Adjustment

Mechanism (CBAM) that would impose tariffs on imports from countries with inadequate climate protection standards in order to prevent “carbon leakage” caused by trade. China has already voiced its opposition to the introduction of this mechanism. And although the Biden administration is considering the possibility of an American CBAM, this issue will nonetheless lead to tensions with the United States. The EU and Germany need to find solutions that enable them to strengthen the global trade and climate agenda while simultaneously minimizing global conflicts.

RECOMMENDATIONS Support for WTO Reform

As the largest EU member state, Germany has a responsibility to place the EU's reform proposals (from February 2021) for the World Trade Organization at the top of the agenda and to work toward a multilateral agreement. Germany should complement the European Commission's efforts to bring both the United States and China on board, especially with regard to urgent reform of the dispute settlement process, which can only be achieved

in partnership with the United States. Germany and the EU must also press for the successful completion of the negotiations on digital trade by November 2021. It is also possible for the Environmental Goods Agreement to be revived in 2021–22 in partnership with the United States and China. As important trading partners for both sides, Germany and the EU are perfectly positioned to fully leverage their role in terms of trade diplomacy.

Development of a Positive Trade Agenda with the United States and an Enforceable Trade Policy in Relation to China

It is important to revive transatlantic trade relations and restore confidence. Potential new initiatives with the **United States** include a closer and more coordinated approach to China and enhanced cooperation at the nexus of trade and security. The Economic Dialogue between the United States and Germany launched by German Chancellor Angela Merkel and US President Joe Biden in July 2021 offers a good basis to address topical issues such as Nord Stream 2, investment screening in critical sectors, sustainable supply chains, or 5G/6G development. The Economic Dialogue will remain in place after the election. At the same time, it is important to reach agreement on secure data transfer in the transatlantic market as quickly as possible. With President Biden in office, the chances for this are good.

In relation to China, the member states (including Germany) have tended so far to prioritize their short-term national self-interest. This will probably change in Germany after the Bundestag election. The aim must be to achieve closer cooperation at the EU level. Germany has a special role to play in fostering cohesion around common European, and potentially transatlantic, positions. This applies to economic and security issues – such as dealing with cyberattacks and with

Huawei regarding the development of 5G – but also human rights and sustainable development issues. Past cooperation among Germany, France, and Italy led to the introduction of European investment screening, for example, which is intended to prevent the takeover of strategically important companies in Europe, especially by Chinese state investors.

Ratification of FTAs and Support for Enforceable Sustainable Development Chapters

It is important for Germany, as Europe's largest economy, to be at the forefront of the ratification of comprehensive, sustainable trade agreements. An important first step would be for the new German government to submit CETA to the German Bundestag for ratification. Germany should also support the European debate on making the Trade and Sustainable Development chapters in free trade agreements enforceable.

Support for a Climate Club

Regarding its commitment to climate neutrality, Germany must play a pioneering role by pursuing the green transformation of its economy. This has implications for trade. At the international level, Germany should therefore press for the revival of the plurilateral agreement to abolish tariffs on environmental goods – the Environmental Goods Agreement – within the EU framework. Regarding the introduction of the CBAM, Germany could, following the election, support the establishment of a climate club in order to minimize potential tensions by establishing global minimum standards on trade and climate issues.

In this memo series, DGAP offers concise analysis of issues related to foreign and security policy that will shape the agenda of Germany's next legislative period. Each memo provides insight on how the new federal government and parliament can take advantage of opportunities and meet challenges as European and global dynamics grow increasingly complex. Topics include technology, climate, migration, the international order, security, and geo-economics.

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DGAP

Advancing foreign policy. Since 1955.

Rauchstraße 17/18
10787 Berlin
info@dgap.org · www.dgap.org
@dgapev

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