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# INTERNATIONAL REPORTS

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Dear Readers,

The World Trade Organisation is sounding the alarm bells over it, as is the International Monetary Fund. The World Economic Forum is even asking whether it will spell the end for economic development among some sections of the global population. They are talking about geoeconomic fragmentation, in other words, the realignment of international trade flows along political blocs, thus the end of globalisation – at least as we have known it over recent decades, where economic efficiency was the key criterion for the alignment of goods and financial flows.

International economic and financial organisations are responsible for drawing attention to developments that could impair the economic welfare of the world's population. Accordingly, these institutions calculate how large growth losses could be due to politically induced shifts in economic relations under this or that scenario. Of course we should take these risks seriously. At the same time, it is the task of policymakers to keep an eye on the big picture. And there are many other aspects to consider in addition to purely economic considerations, first and foremost preserving the security and independence of one's country and the people who live in it.

This is all the more true in a world where key players such as Russia and China do not hesitate to use the economic dependencies of other countries as a political weapon. So, whether we like it or not, decision-makers in Germany and Europe have to find a new balance between economic and geopolitical concerns. This issue of International Reports seeks to contribute to the discussion about which principles should guide them.

**Security before profit maximisation.** In the vast majority of cases, these two objectives are not contradictory. Indeed, the opposite is true: if we have a strong economic base, this also strengthens our political position on the international stage. However, in the event that decisions made by private companies could, in the medium or long term, result in dependency on other countries that are likely to become our adversaries on this international stage, then politicians can and should intervene. Germany's centrist parties now largely agree that it was a mistake to not only do nothing to avoid the country's gas dependency on Russia, but to drive it forward politically. It is important not to repeat this mistake with regard to China, which, according to experts, has far more scope to cause us harm in the event of a conflict compared to Russia, since the German and Chinese economies are linked in a completely different way.

**As much intervention as necessary, as much freedom as possible.** As important as it is for the state to intervene in economic relations that have security implications, it is equally important that it stays out of engagements that do not raise security concerns – and that is clearly the majority. With this in mind, Gunter Rieck Moncayo argues in his article for a targeted approach to the necessary geostrategic readjustment of our foreign trade policy. The liberal global economic order established after the Second World War brought prosperity, first to West Germany and later to Germany as a whole. Today, it is important to make the necessary adjustments within this order – to stand up for its rules without acting naively. However, those who, in the slipstream of current developments, want to pursue industrial policy and protectionism on a large scale and for their own sake, thereby taking an axe to that order, will neither increase our prosperity nor our security.

**Free trade talks should not be overloaded with other issues.** Politicians in large swathes of Germany and Europe generally agree that we should reduce dependencies, particularly on revisionist autocracies. Particularly with regard to China, there is much talk of "diversification" and "de-risking". There is a desperate search for new business partners. Yet there is also a gap between words and actions. It is true that Germany is cancelling federal guarantees for business in China and granting them for projects in other countries. That is the right thing to do. However, policymakers should focus much more on removing existing trade barriers – and these are now increasingly non-tariff barriers in addition to traditional tariffs – for our companies, making it easier for them to work with countries in Southeast Asia, South America or Africa and thus diversify German and European supply chains, or enabling them to do so in the first place. In concrete terms, this means signing free trade agreements with the countries and regions concerned as quickly as possible. This is also important because other players – China, of course, but also countries like Turkey and the United Arab Emirates – are now overtaking us in some regions of the world, as Lukas Kupfernagel points out in his article on Africa.

However, the European Union has proved to be virtually paralysed in this area for years. We have become used to the fact that there is still no free trade agreement even between the EU and the US, but this does not make the situation any less worrying – especially in the current global situation. But when we cast our gaze beyond the established industrial nations, here, too, things are not looking good. The most drastic example is the 25-year-long negotiations with the South American MERCOSUR bloc, yet the situation is similar when it comes to trade talks with an emerging country such as Indonesia, as Denis Suarsana explains in his article.

Alongside the specific economic interests of certain groups in Europe and the respective negotiating partner, further complications arise due to the Europeans' increasing tendency to complicate the talks by attempting to use free trade agreements to push through non-trade demands such as far-reaching social, environmental and human rights standards. These are often perceived as patronising and overbearing by the partner on the other side of the negotiating table. Of course, these are important issues, but the EU and its member states should look for other ways of addressing them when talking to their partners. Today, these countries have other economic options besides Europe and, if in doubt, will simply allow the trade talks to fail. The result: no environmental standards, no free trade. If we Europeans then make it even more difficult for companies to enter the markets of many potential diversification candidates by imposing excessive requirements – such as the German Supply Chain Act and the corresponding EU directive – the de-risking rhetoric begins to ring hollow.

**Geoeconomic competitiveness demands economic competitiveness.** Just as we should try to remove external obstacles from our economy and avoid throwing additional stones in its path, we should generally devote more energy to making it structurally more competitive. In terms of geopolitics, including vis-à-vis potential opponents, our position varies depending on whether we are economically strong or lagging behind. And the latter threatens to materialise if we do not take countermeasures. Of course, we should not indulge in worst-case scenarios, as the economic challenges elsewhere are also immense, and great ambitions do not always keep pace with reality, as Philipp Dienstbier and Nicolas Reeves illustrate with reference to the Gulf region in this issue of International Reports. And yet growth forecasts for the near future speak for themselves. Not only is Germany at the bottom of the table of industrialised nations. Europe could also lose touch with the United States and the North American economic area as a whole, which is increasingly being influenced by strong growth in Mexico, as Hans-Hartwig Blomeier and Maximilian Strobel explain in their article.

Here at home in Germany and Europe, too, we need to return to the strengths of our liberal societies and economic systems. One could also say we need to return to the basic principles of the social market economy: promoting employment and personal responsibility, not dependence on the state; using resources efficiently and in a decentralised manner, with state allocation in exceptional cases only; and viewing new technology not primarily as a threat but as an opportunity, for example in the regulation of artificial intelligence.

It has almost become a truism but the world has indeed become a tougher place for Germany, Europe and the political West as a whole over the past two decades. And just as these conditions are forcing us to rethink our approach to armaments and defence, this is also the case with regard to our economy. The realisation has dawned very late in both these cases, especially in Germany, where a change of direction is particularly challenging both materially and often intellectually. But in both cases, it is also true that if we refuse to face reality and simply do business as usual, we will soon find ourselves in dire straits.

I hope you find this report a stimulating read.

Yours, Gerhard Wahlers

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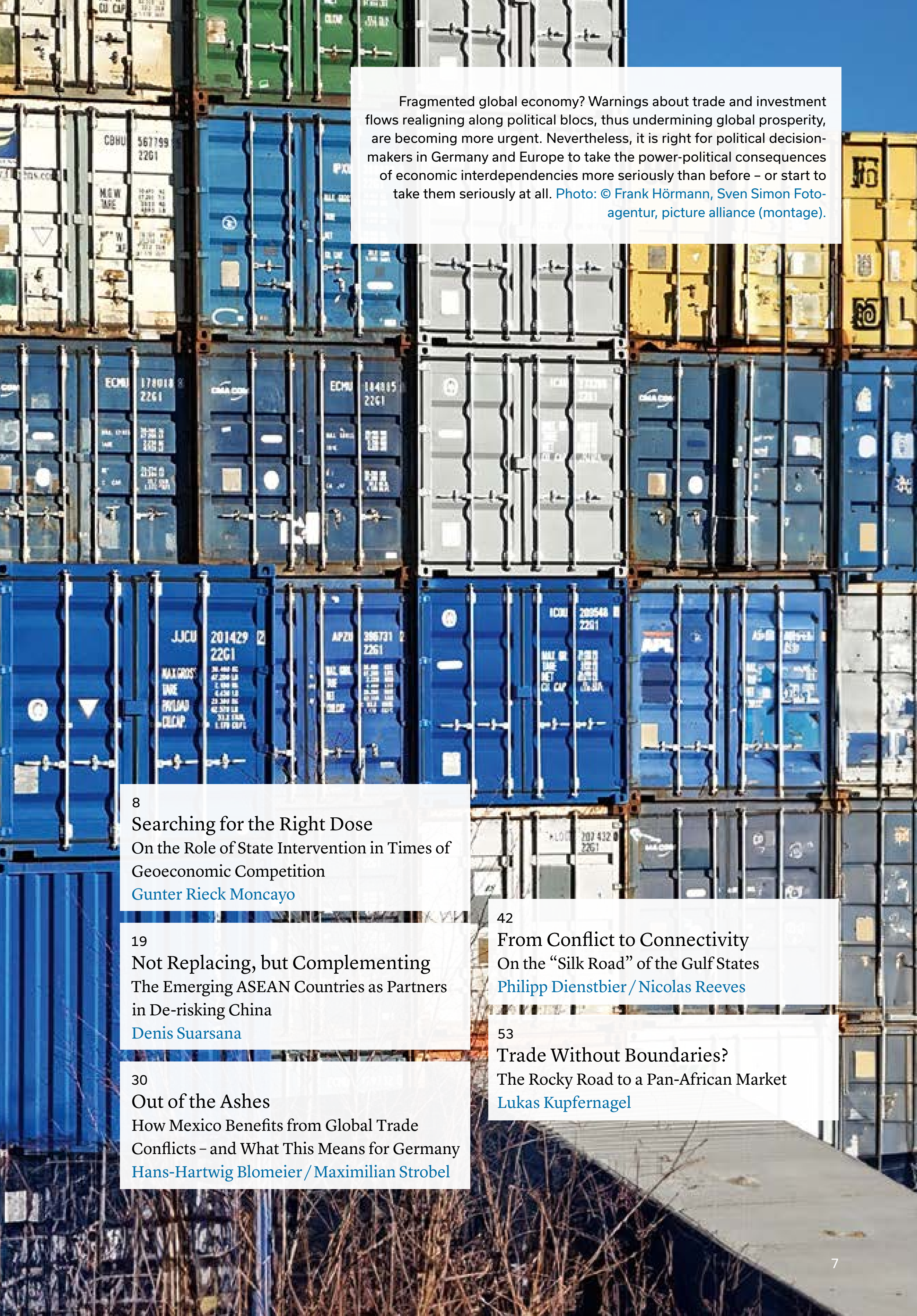


Fragmented global economy? Warnings about trade and investment flows realigning along political blocs, thus undermining global prosperity, are becoming more urgent. Nevertheless, it is right for political decision-makers in Germany and Europe to take the power-political consequences of economic interdependencies more seriously than before – or start to take them seriously at all. Photo: © Frank Hörmann, Sven Simon Fotoagentur, picture alliance (montage).


Photo: © Mads Claus Rasmussen, Ritzau Scanpix, picture alliance.

What Will Become of Globalisation?

# Searching for the Right Dose

## On the Role of State Intervention in Times of Geoeconomic Competition

Gunter Rieck Moncayo

For Germany and Europe, the geopolitical environment has deteriorated massively. Our foreign trade policy cannot ignore this fact. That is why the term "de-risking" is on everyone's lips. The demand on the state to intervene in economic relations if necessary to protect its own security is increasing. That is quite right, as long as we realise two things: more is not necessarily better. And even the best de-risking instruments are of little help without your own competitiveness.

It was a boom with a bang: since 5 July 2024, manufacturers of battery electric vehicles (BEVs) from the People's Republic of China have to pay a so-called countervailing duty of up to 37.6 per cent in the form of bank guarantees if they want to import their cars into the European Union. According to the European Commission, these duties are intended to compensate for the unfair competitive advantage enjoyed by Chinese manufacturers owing to state subsidies. In doing so, the Commission drew on its geoeconomic toolbox, which it has greatly expanded in recent years in response to the changing global political situation.

There were mixed reactions to the Commission's decision: while a survey conducted by the German Economic Institute (IW) showed a clear majority of companies (eight out of ten) in favour of the announced measure,[1] many observers warned of Chinese countermeasures and an escalation into a trade war.[2] In the short term, however, the European show of power was successful, at least in the sense that only ten days after Brussels informed of its plan on 12 June 2024, negotiations were announced between the European Union and China to find an amicable solution. However, China will initially respond with its own measures.

Only time will tell to what extent the feared trade war will actually materialise. Meanwhile, Europe has demonstrated its ability to act on the geoeconomic stage, despite all the prophecies of doom.

**The New Geopolitical Reality**

At the end of 2019, Ursula von der Leyen caused astonishment when she announced at the beginning of her first term as Commission President that she wanted to lead a "geopolitical commission".[3] From now on, global power politics was also to be conducted from Brussels and no longer only in Member States' capitals. And even if it was not entirely clear at the time what this announcement would mean in practice, the new geopolitical reality quickly showed that the European Union could not avoid aligning its external action more closely with interests of power politics and possibly also using economic instruments to achieve them.

Following Russia's attack on Ukraine, a gas embargo was hotly debated in Germany, aimed at cutting off an important source of Russian revenue to finance the war. At its core, the debate centred on the dependence of Germany's energy supply on gas imports from Russia. The question was: are we even in a position to play this trump card? Or do we end up harming ourselves more than the other side? The discussion was finally brought to an end by Russia itself, which first reduced gas supplies to Germany and then stopped them completely.

However, even prior to the Russian invasion of Ukraine and the associated debates about dependence on gas supplies, the issue of economic resilience had gained in prominence in the political and public arena as a result of

The subject of the dispute: The EU Commission accuses China of conquering the European market with subsidised electric vehicles and imposed countervailing duties on 5 July 2024. Photo: © Frank Hörmann, Sven Simon Fotoagentur, picture alliance.

various disruptions to value chains. For example, empty shelves in the wake of the fight against the coronavirus pandemic and supply bottlenecks due to the blockade of the Suez Canal caused by the Ever Given container ship accident in March 2021, have markedly demonstrated the vulnerability of global supply chains. In an era when just-in-time production with the smallest possible stocks had become the standard, these disruptions had far-reaching consequences, and further disruptions to delivery routes are likely to occur in the future. The consequences of climate change only add another "source of error", as recently demonstrated by a drought in Central America, which temporarily reduced the capacity of the Panama Canal by 40 per cent. This resulted in long waiting times and detours with corresponding delays at the ports of destination.

**De-globalisation is by no means occurring, but rather a reorganisation of globalisation.**

More than ever, though, the resilience of an economy must also be measured by its ability to respond to geoeconomic attacks, as shown by the example of the Russian gas tap being turned off for Germany in 2022. This is not a new phenomenon, just look at the conflict between Japan and China over rare earths since 2010.[4] Yet, there is no doubt that geopolitical tensions are rising and potential conflicts involving Europe are at least becoming more likely.

It is important to note that despite these shocks, global trade has continued to grow unaffected, at least for now. Contrary to predictions by some observers at the peak of the coronavirus shock, de-globalisation is by no means occuring.[5] But what is actually happening is a reorganisation of globalisation, a re-globalisation in which various processes are taking place in parallel: fragmentation, regionalisation, diversification.

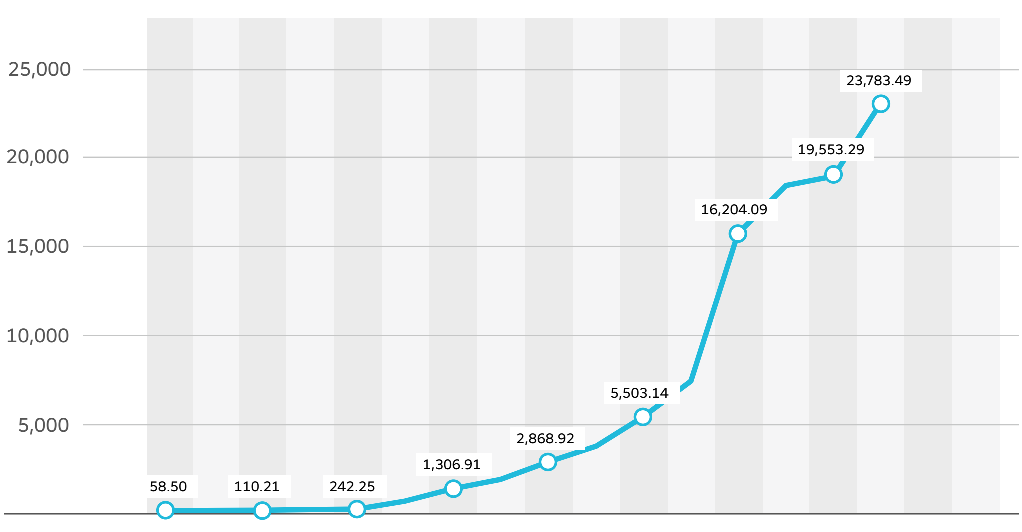
**Germany's industry is more dependent on China than any other in Europe.**

## De-Risking Is the Order of the Day

The buzzword par excellence in these times of re-globalisation is "de-risking". The term originates from the world of finance. It describes the termination or restriction of business relationships by financial institutions with certain customers or customer groups so as to exclude risks ("avoid, rather than manage, risk"). The "new" de-risking in the geoeconomic context is also about reducing risks in economic relationships, but without breaking off the relationships completely.[6]

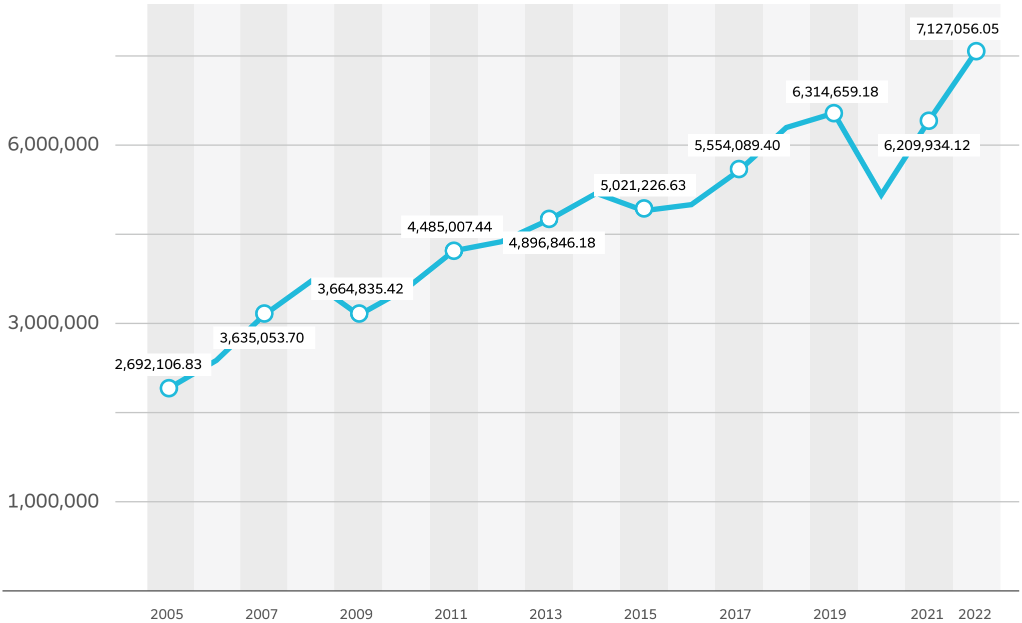
The main aim is to reduce dependencies in value chains that could be exploited by third parties to achieve geopolitical goals. Now, dependencies in the economic sphere are not bad per se. Quite the opposite: the concept of the global division of labour is based on the fact that not every economic unit holds the entire value chain in one hand. Exchange and specialisation create added value for all sides, giving rise to a deliberate dependency for mutual benefit. It is to be assumed that the decentralised spontaneous organisation of these diverse dependencies can be brought about more efficiently by the market

**Fig. 1: Global Volume of Trade in Goods from 1948 to 2023 (in Billions of US Dollars)**




Source: own illustration based on Statista 2024: Entwicklung der weltweiten Exporte im Warenhandel von 1948 bis 2023 (in Milliarden US-Dollar), 10 Apr 2024, in: https://ogy.de/ngou [11 Jul 2024].

**Fig. 2: Global Trade Volume for Services 2005 to 2022 (in Millions of US Dollars)**




Source: own illustration based on Statista 2023: Entwicklung der weltweiten Exporte von Dienstleistungen im Zeitraum 2005 bis 2022 (in Millionen US-Dollar), 16 Aug 2023, in: https://ogy.de/wtm7 [11 Jul 2024].

players than central government coordination could ever guarantee.

Having said that, critical and therefore potentially dangerous dependencies may arise that require government intervention. The danger lies in the fact that in times of increasing geopolitical fragmentation, other states could exploit dependencies to further their interests of power politics, for example by provoking disruptions to supply relations. Import dependencies on China are a particular focus here. Germany's industry is more dependent on China than any other in Europe, both for the import of raw materials and primary products, and as a sales market.

At first glance, the dependence on China does not appear to be too great, as the People's Republic accounts for only nine per cent of Germany's foreign trade.[7] At second glance, however, dependencies that have become entrenched over long periods of time are clear to see, where a breakdown in supply relationships would have far-reaching (not only economic) repercussions and where substitution is hard to achieve. However, these truly critical dependencies apply to far fewer imports than is generally assumed, and especially include pharmaceutical products and some raw materials such as scandium, yttrium, graphite, germanium and magnesium.[8]

**It is to be expected that companies will hedge less against geopolitical risks than would be necessary.**

There is a passionate debate about how to respond to this situation. Near-shoring, in which the individual production steps are geographically closer together again, may have been an understandable approach at the onset of the polycrisis outlined above, whereby disruptions along the supply chains occurred rather accidentally and without political influence due to the consequences of the pandemic and the blockade of the Suez Canal. However, such an approach will not help against geopolitically motivated, deliberate disruptions.

In response to this new threat, so-called friend-shoring quickly emerged, in which geopolitical, rather than geographical, distances were to be minimised. Yet, the truth is that a supposedly brave new world where we only trade with like-minded value partners would not only be very small, but also very limited in terms of supply. It thus seems more expedient to have a mix of larger stockpiling to bridge short-term disruptions in supply chains and greater diversification of sources of supply to reduce dependence on individual countries over the medium to long term.

**Structural Challenges for Companies**

In a social market economy, companies are the primary addressees of all such considerations. For them, assessing risks in their production processes is always an important task. However, any hedge against risks is associated with costs, whether through increased warehousing or the diversification of supply relationships. From a business perspective, it is important that the cost of hedging against a particular risk is always in relation to the potential loss. In this sense, de-risking works like a classic insurance policy in this context: you pay a premium (cost of de-risking) to protect yourself against a loss event (disruption of supply relations). The problem here, however, is that the probability of occurrence cannot be calculated, particularly in the case of geopolitical risks. Therefore, it is generally not possible to insure against losses caused by such business interruptions on the open market.[9]

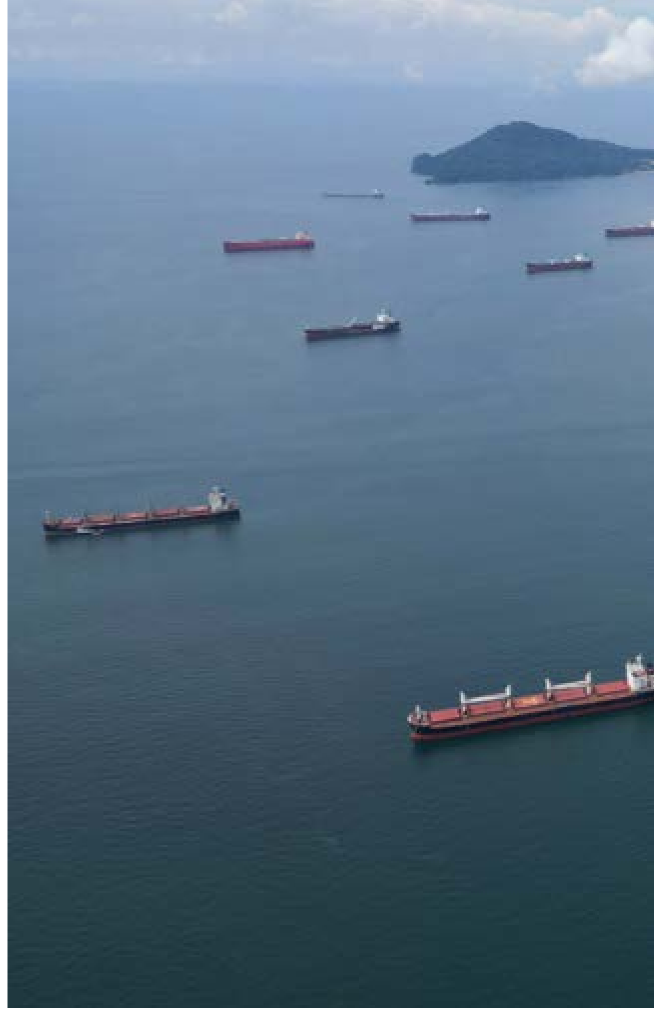
Companies therefore face the enormous challenge of determining the right level of de-risking. In a highly competitive environment, it is not surprising that companies avoid additional costs with an immediate impact if they cannot safely assess the potential medium to long-term benefits. We can thus expect that companies will tend to hedge less against geopolitical risks than would be necessary for society as a whole. This is all the more true if companies assume, based on experience, that they will be cushioned by government support measures in the event of major upheavals. The costs are thus shifted, sometimes with active support from policymakers, from the company to future taxpayers, who will have to finance the government's additional debt service.

## A look at the diversification efforts of German companies paints a mixed picture.

A further complicating factor for companies is that a monopolistic supplier structure means that it is simply impossible for individual customers to diversify their supply relationships. Especially in the processing of strategic raw materials, China has achieved a market power to which no alternative has yet been established. The demand for battery raw materials for the energy and mobility transition and for the ongoing digitalisation of society will further intensify these dependencies, as China is the dominant market player here.

A look at the diversification efforts of German companies in terms of de-risking from China therefore paints a mixed picture: in 2023, only 37 per cent of German companies were still dependent on upstream products from China, compared to 46 per cent prior to the start of the Russian war of aggression against Ukraine. At the same time, however, the number of companies that want to further reduce their dependency has also decreased. In some cases, dependency on imports has even increased because, for example, some primary products in the chemical industry are no longer produced in Germany at all due to the rise in energy prices.[10] Jürgen Matthes from IW Cologne recently summarised the findings as follows: "On this basis, there is hardly any sign of structural de-risking of imports in 2023, although total German imports from China have fallen by almost a fifth."[11]

The lack of visibility of private diversification efforts is also partly due to value chains increasingly being considered regionally rather than globally in the sense of a "local for local" approach. The aim is to guard against both disruptions to supply routes and protectionist trade restrictions, which are increasingly being employed by states as an instrument of geoeconomic power. In line with this approach, products for the Chinese market are then manufactured locally wherever possible, products for the North American market are manufactured there, and so on. As a result, more investments are being made in China, for example, during the transition phase in order to establish the corresponding value chains locally. The CEO of Mercedes-Benz, Ola Källenius, pointedly expressed his company's prioritisation in the recent past by stating that de-risking for Mercedes means more China, not less.



**Politicians must be aware of their own capabilities and limitations.**

### Would the State Please Take Over?!

Thus, if structural challenges mean that decentralised risk minimisation by companies falls short of the optimum for society as a whole, central government coordination appears to be necessary. In fact, the state can use cleverly designed de-risking to resolve the dilemma for companies and secure the competitiveness of its own economy in the long term. However, it is crucial that politicians are aware of their own capabilities and limitations.

A lack of information also makes it difficult for political decision-makers to assess the extent to which de-risking is necessary to achieve the socially optimal level. As with companies that have to accept higher costs in the short term as a result of their own de-risking efforts, society is initially threatened with a loss of prosperity owing to centrally coordinated de-risking measures. And even if these short-term losses in prosperity must of course be set against any medium to long-term positive effects, the existing uncertainty leads to calculation problems. What is more, government decision-makers do not bear the resulting costs themselves, but impose them on other stakeholders – either as direct costs in the form of taxes, levies and additional compliance costs or indirectly through higher debt. This can soon result in state-coordinated de-risking becoming too far-reaching and the costs for society as a whole being higher than the potential damage against which it wants to protect itself. Clever policy should avoid this.

After all, we cannot afford this loss of prosperity. That is partly because, as an ageing society with stagnating productivity, we do not want to give up the social benefits we have come to

Traffic jam: In August 2023, container ships piled up at the entrance to the Panama Canal, whose capacity had been significantly reduced by persistent drought. Such natural events are a risk factor for world trade alongside politically induced disruptions. Photo: © Mauricio Valenzuela, dpa, picture alliance.

value. In addition, the necessary transformation of the economy and society towards climate neutrality incurs enormous costs (at least in the short to medium term), which also have to be covered.

**There is no way around the strategic use of geoeconomic instruments.**

However, despite all the hurdles and risks, there is no way around the strategic use of geoeconomic instruments, of which de-risking is just one component. And since large parts of foreign trade policy fall exclusively within the competence of the European Union, the specific organisation of geoeconomic instruments is determined at European level. The corresponding toolbox has been greatly expanded in the recent past. There are now more than 20 different tools and strategies that can be grouped into three categories:[12]

1. Instruments to safeguard a level playing field with third countries, such as the anti-subsidy investigation, which has now led to the above-cited countervailing duties for Chinese electric cars;

2. EU instruments bridging the economic and security domains: the so-called anti-coercion instrument against economic coercion

by third countries, screening of foreign direct investments in Europe, export controls and outbound investment screening;

3. EU strategies to support its geoeconomic agenda, including the Cybersecurity Act, the Internal Market Emergency and Resilience Act, the scientific research framework programme Horizon, the European Chips Act and the Net Zero Industry Act.

This list gives an idea about how complex the implementation of a geoeconomic agenda is. In particular, there is a tendency towards a very high density of regulation, with some provisions immediately creating the need for the next regulation. In the worst case, the result is a political patchwork.[13]

The potpourri of different instruments and strategies with which the European Union seeks to ensure its geoeconomic capacity to act raises the question of when the state exceeds the limits of its capacity. The wide-ranging competences, which sometimes lie with the Member States, sometimes with the Commission – and there again, depending on the measure, either with the Directorate-General for Trade (DG Trade), the Directorate-General for the Internal Market, Industry, Entrepreneurship and SMEs (DG Grow), or the Directorate-General for Competition (DG Comp) – or the European External Action Service (EEAS), further increase the risk of the state overstretching itself. Given the very limited number of critical dependencies, which can be restricted to just a few products, fewer, but more precise instruments seem to be required.

It would be more than just collateral damage if, in addition to the critical dependencies, non-critical economic exchange relationships were also affected by overly ambitious regulatory zeal. There is little point in criticising dumping from China when it comes to products that can be produced more cheaply there than in Germany, even without state subsidies. Eliminating or even artificially increasing the price of these cheap imports would have an inflationary effect and further delay the implementation of the energy and mobility transition.[14]

**European trade policy is currently dysfunctional on virtually all fronts.**

### Focus on Your Own Economic Strength

In any case, it is crucial for the successful implementation of a geoeconomic agenda to focus on our European and German competitiveness. After all, our own strength is the best tool for greater resilience. To this end, the ability to innovate should be strengthened and weaknesses in the financing of start-ups should be addressed, for example by enabling public institutional investors to invest in venture capital and improving the tax position of entrepreneurial investments in research and development.[15]

There is also an urgent need to make European trade policy work again, so that business diversification can develop with as little disruption as possible. European trade policy is currently dysfunctional on virtually all fronts. The fact that the negotiations with Australia are failing; that there is a de facto deadlock with MERCOSUR; that the ratification of CETA is not in sight; and that an agreement with the United States is currently inconceivable (especially if Donald Trump were to be elected for a second term in office) is a trade policy disaster in itself. That this is happening at a time when risks should actually be minimised through greater cooperation with like-minded countries makes the failure inexcusable. Europe is in danger of losing touch with the rest of the world, and no amount of geoeconomic instruments can compensate for this.

Too many non-trade issues have been included in trade talks over the years, where the interests of our potential partners diverge so much that successful deals are prevented. And we are too unwilling to recognise that our protected agricultural markets, which distort competition, are a major source of irritation for many potential partners. We need a new way of thinking to prepare Europe for the future. In any case, the trade talks should be less comprehensive, so that the end result is an "EU-only" agreement that does not require the Member States' approval for full entry into force.

In contrast to "EU-only" agreements, comprehensive agreements are currently being negotiated that not only concern areas of exclusive EU competence, but also areas of competence of the Member States. These so-called mixed agreements must therefore not only be ratified at EU level, but also by the Member States themselves in order for them to fully enter into force. This has started to slow Europe down.

Germany and the European Union should continue to review regulations to determine the extent to which they harmonise with the objectives of de-risking and diversification. The German Supply Chain Act and the European Supply Chain Directive CSDDD, for example, make diversification more difficult and thus consolidate China's dominant role. This is not what a coherent policy looks like.

It is right and important for the state to focus on risks that could jeopardise our ability to act. However, it must not overshoot the mark: if more and more details are regulated and entrepreneurial decisions are increasingly controlled, the function of free competition as a process of discovery is compromised and, with it, the greatest economic strength we have to offer as a free society. Yet, our strength and ability to innovate should always be the measure of all things. For only through our own strength can we ensure that dependencies are mutual and that they cannot be used against us.

*– translated from German –*

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What Will Become of Globalisation?

# Not Replacing, but Complementing

## The Emerging ASEAN Countries as Partners in De-risking China

Denis Suarsana

Germany and Europe have to reduce their economic dependence on China. In this context, the emerging economies of the Association of Southeast Asian Nations (ASEAN) afford potential for diversification. Yet, if this potential is to be exploited, the European Union has one particularly urgent task. Free trade negotiations with the emerging countries of Southeast Asia are currently overloaded with non-trade demands; the EU must return the focus to the core issues and bring talks to a swift conclusion.

As part of its China strategy, the German government is striving to de-risk its economy, meaning it seeks to reduce its economic dependence on China. A key part of this project is greater diversification of the German economy – both in view of China's central importance in international supply chains and the marked dependence of many German companies on the Chinese sales market.

In Germany and Europe, at least, there is no longer any talk of wholesale economic de-coupling from China. Instead, the German government aims to "promote the diversification of our economic relations so that we will continue to participate in China's economic development while reducing our dependence in critical sectors". This is because China continues to be "of great importance for many companies owing to its share of the global market, its dynamism and innovativeness".[1]

However, how such de-risking is to be successfully implemented largely remains unclear. The German government understands that, in addition to improving economic conditions in Germany and Europe, it is also important to make "better use of the strong potential of other countries and regions"[2]. But which countries and regions harbour such strong potential? How and where should German and European companies diversify so as to reduce their dependence on China?

These questions are not easy to answer, especially for Germany, which is more economically linked to China than any other country in Europe. The People's Republic is its most important trading partner, with Germany accounting for almost one third of all trade between China and the EU. It is therefore clear that diversification away from China requires tremendous effort – and economic partners with the necessary growth potential to even be considered a serious alternative.

In the search for suitable partners, politicians and businesses often turn to the emerging economies of Southeast Asia. The dynamic growth and relatively large markets of the so-called Emerging ASEAN (Indonesia, Malaysia, Thailand, the Philippines and Vietnam) offer a seemingly promising alternative to their large neighbour, China. However, economic data reveals that the emerging economies of Southeast Asia do not offer unlimited potential for diversification. Having said that, this does not mean that the Emerging ASEAN cannot be attractive for German and European companies. The region offers considerable potential, particularly for companies that (have to) pursue a China+1 strategy, i.e. remain engaged in the People's Republic while also diversifying into other locations and markets to reduce their own dependence on China. The Emerging ASEAN cannot replace China, but they can certainly complement it.

## Close Ties with China Become a Problem

China is now the second largest economy worldwide and, even after decades of high growth rates, it continues to be the driving force behind the global economy. Despite the current economic slowdown, forecasts by the International Monetary Fund (IMF) indicate that the Chinese economy will contribute more than 20 per cent to global economic growth over the next five years – more than any other economy in the world.[3] By contrast, the share of other emerging Asian countries such as India or the Emerging ASEAN lags well behind China. Emerging markets outside Asia only play a subordinate role. Therefore, economically, China will remain eminently important in the coming years; this is particularly true for Germany and the EU, with their economic model based on global trade and open markets.

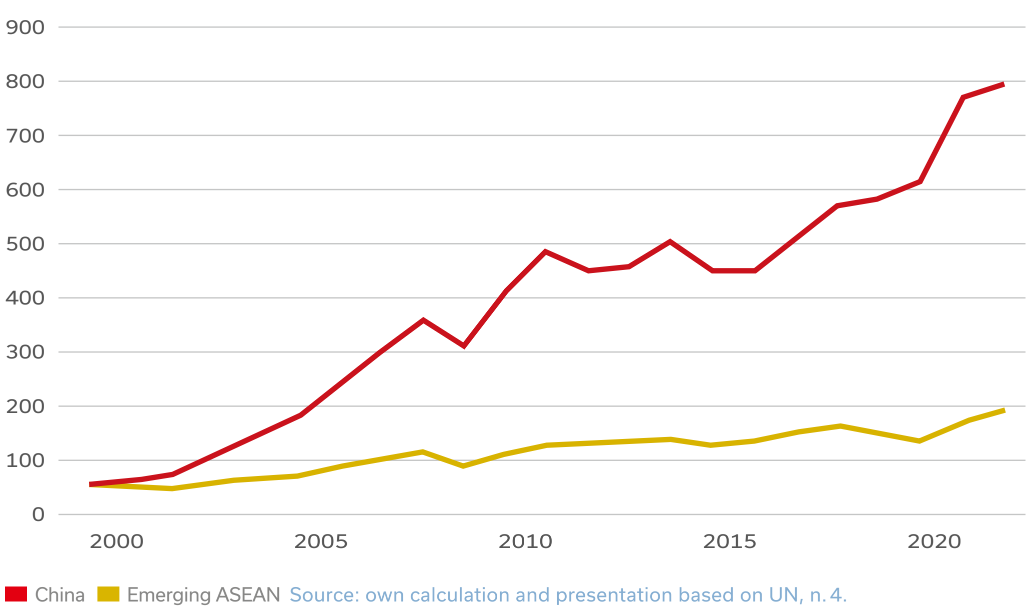
**For many European companies, the market environment in China is becoming challenging.**

China is the EU's most important trading partner. In 2022, the total trade volume (imports and exports) between the EU and China exceeded 797 billion US dollars. In contrast, the trade volume with the Emerging ASEAN is just under 189 billion US dollars – even though the figure for China and the Emerging ASEAN in 2000 was almost the same at around 55 billion US dollars (figure 1).

The Chinese economy is of particular importance for Germany. Almost half of all European exports to China are attributed to German companies. Although the volume of foreign trade between Germany and China in 2022 was 229.5 billion US dollars, below the record figure for 2021 (237.7 billion), it still exceeded the pre-COVID level by more than 40 billion US dollars. In contrast, Germany's volume of foreign trade with the Emerging ASEAN was only 47.8 billion US dollars in 2022, even slightly below the pre-pandemic figure.[4]

For many European countries, however, the market environment in China is becoming increasingly challenging. With its "Made in China 2025" strategy, the Chinese government seeks to reduce its technological dependence on other countries and is investing heavily in the competitiveness of Chinese companies within numerous key industries.[5] This means German and European companies will face growing domestic competition on the Chinese market. It

**Fig. 1: EU Trade Volume in Billions of US Dollars**



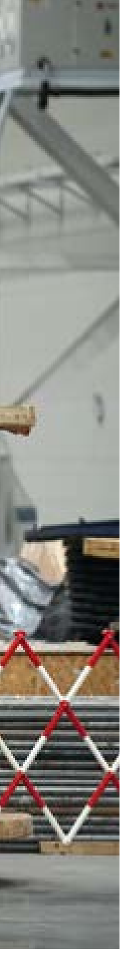

Source: own calculation and presentation based on UN, n. 4.

The air is getting thinner: The market environment in China has deteriorated for European companies, not least due to competition from local companies massively subsidised by the state. The picture shows the plant of a German gearbox manufacturer in Tianjin province. Photo: © Sören Stache, dpa, picture alliance.

has already been felt in mechanical engineering and the automotive industry, where German companies recently lost market share to Chinese companies.[6] In view of the Chinese sales market, diversification is thus not only a question of risk mitigation for European companies, but also an economically necessary strategy to tap into alternative markets with growth potential for their products over the long term.

If the EU is to consider the Emerging ASEAN countries as a real alternative to China in the coming years, they would need to embark on an economic race to catch up and demonstrate far stronger growth momentum than China. Only then could they contribute to a substantial shift in European trade flows away from China and into the region, potentially significantly reducing the enormous gap relative to trade volume between the EU and China. However, a glance at the growth forecasts for China and the five Emerging ASEAN countries gives little reason for such hope.

The IMF predicts a GDP growth rate of 4.2 per cent for China in 2024, placing it roughly on a par with Malaysia (4.3 per cent) and well above Thailand's 3.2 per cent economic growth. While the IMF forecasts that China's growth will lose steam by 2028, the same applies to the economic development of Malaysia and Thailand. For Indonesia, the IMF expects a consistent annual growth rate of five per cent over the next five years. Only for the Philippines and Vietnam, the two economies with the lowest per capita income in the Emerging ASEAN, does the IMF predict a more dynamic development with growth rates of well above six per cent by 2028.[7]



However, even such growth rates are too low for emerging and developing countries striving to catch up with far more developed economies. South Korea, perhaps the most successful of the East Asian tiger economies, achieved double-digit growth rates in the 1980s. And China's economy enjoyed double-digit growth for decades.

**China is now by far the most important economic partner for the countries in the region.**

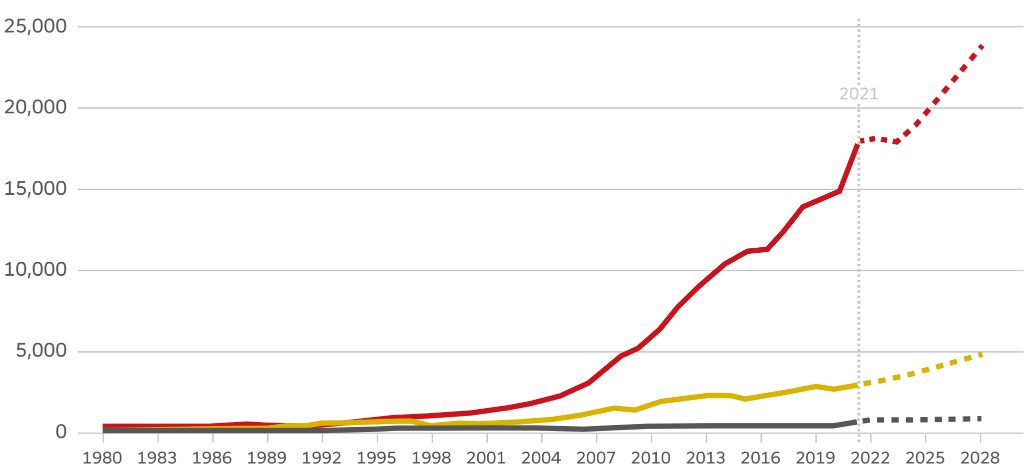
In terms of overall economic performance, the growth rates of the Emerging ASEAN, which are rather moderate when put in a historical perspective, mean that these countries will be unable to narrow the large gap with China. If anything, China will actually expand its lead in the coming years. China is expected to increase its GDP from the current 17.7 trillion US dollars (2023) to 23.61 trillion by 2028, while the Emerging ASEAN will only increase from 3.23 trillion US dollars (2023) to 4.73 trillion (figure 2). In other words, the Chinese economy will grow by more in the next five years than the entire projected economic output of the Emerging ASEAN in 2028 – China's economy will have grown by an entire ASEAN by 2028.

### The Dangers of Pseudo-Diversification

In addition to the – by historical standards – moderate growth rates of the Emerging ASEAN, another factor complicates the diversification of German and European economic relations from China to the region. Despite all the aforementioned data, ASEAN is one of the most dynamic economic regions in the world, so it is also attracting other economic powers. Japan, South Korea, Australia, the US and many others are expanding their economic ties with the economies of Southeast Asia. Having said that, the EU's fiercest economic competitor in the region is China itself.

In recent years, China has gained tremendous economic importance, not only for the EU, but also for the countries of Southeast Asia. China benefits from the ASEAN-China Free Trade Area (ACFTA) and from being a member, together with the ASEAN countries, of the Regional Comprehensive Economic Partnership (RCEP), the largest free trade zone in the world – unlike the EU, whose trade negotiations with

**Fig. 2: Gross Domestic Product in Billions of US Dollars**




Years 2021 to 2028 as forecast. China Emerging ASEAN Other ASEAN countries
Source: own illustration based on IMF 2024, n. 3.

the Emerging ASEAN countries have stalled since the successful conclusion of negotiations with Vietnam in 2019.

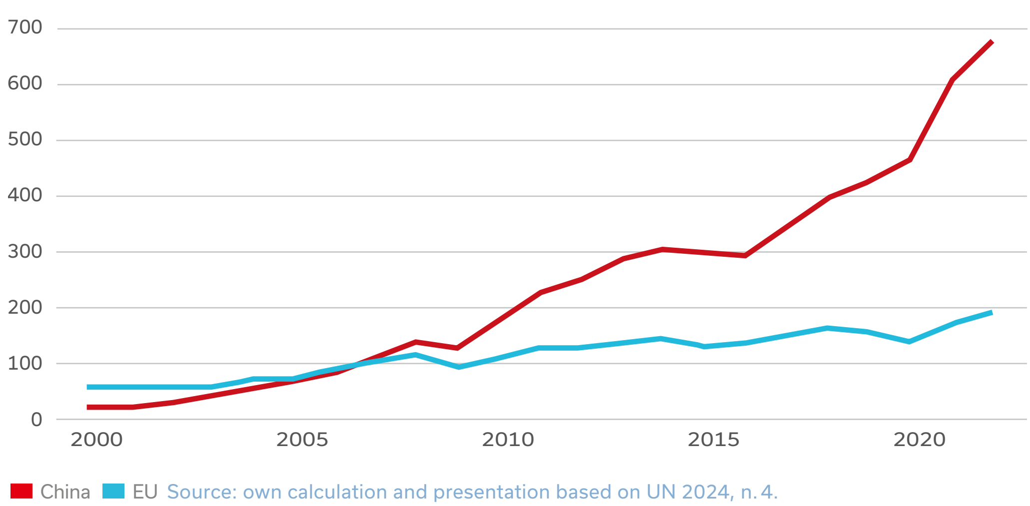
China is now by far the most important economic partner for the countries in the region. While the volume of trade between the EU and the Emerging ASEAN has grown relatively slowly in recent years, the volume between China and the Emerging ASEAN has almost doubled over the past five years (figure 3).

## European companies are at a major disadvantage due to the lack of free trade agreements.

China also dominates the industrial supply chains in the Emerging ASEAN with an enormously high share of all primary product imports. More than one third of all imported primary products in Indonesia originate from China. In Vietnam, the share is 29.5 per cent, in Thailand 28 per cent, in the Philippines 26.9 per cent and even in Malaysia it lies at an impressive 17.4 per cent. In comparison, the share of Chinese primary product imports in Germany, which is particularly criticised for its strong dependence on China in terms of industrial integration, is just 12.4 per cent.[8] The high proportion of Chinese primary product imports in the Emerging ASEAN makes it clear that establishing a production site in the region would only reduce dependence on China to a limited extent. German and European companies would probably still rely on a high proportion of Chinese primary products in their factories in Southeast Asia. In this case, a China+1 strategy would ultimately be little more than pseudo-diversification – diversification in terms of geography, but not in terms of supply and value chains.

What is more, protectionist rules in countries such as Indonesia and the Philippines make access to these potentially huge markets costly or, in some cases, virtually impossible. This represents a major disadvantage for European companies due to the lack of free trade agreements. Countries such as Australia, Japan, South Korea and India threaten to outpace Europe thanks to free trade agreements and regional trade zones such as RCEP and CPTPP (Comprehensive and Progressive Agreement for Trans-Pacific Partnership). This is especially true for China, which, thanks to ACFTA and RCEP, has become the most important country of origin for ASEAN imports within just a few years. Between 2017 and 2022 alone, Chinese exports to ASEAN grew

**Fig. 3: Emerging ASEAN Trade Volume in Billions of US Dollars**




Source: own calculation and presentation based on UN 2024, n. 4.

by 70 per cent. This means that China accounts for almost 25 per cent of all imports in the region. 80 per cent of imports from China are industrial goods – primarily electronics, machinery and machine parts as well as chemical products.[9] Hence, these are products with which Chinese manufacturers compete directly with German and European industrial companies on the global market and in the Emerging ASEAN.

**Only in Thailand and Vietnam German direct investment stocks recently increased.**

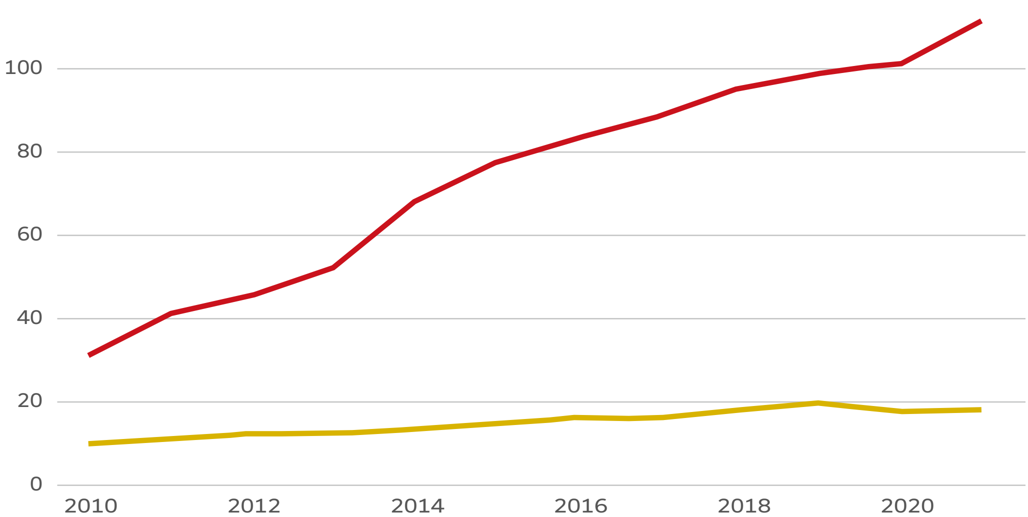
### Diversification of the German Economy Remains Sluggish

Despite all political appeals, there has been little sign of the German economy diversifying away from China. Movement towards de-risking on the part of German companies can only be observed to a very limited extent.[10] For example, in a study conducted by consulting firm PwC, only one per cent of the companies surveyed indicated their intention to give up their operations in China.[11] Other company surveys also demonstrate that a majority of the German companies that rely on inputs from China do not plan to take steps to reduce their dependence on China or even seek to expand their procurement and investments in China.[12]

German direct investments in China have also increased massively in recent years. The stock of all German direct investments in China is currently around six times higher than the value in the Emerging ASEAN (figure 4). In fact, the direct investment portfolios of German companies in the Emerging ASEAN have largely stagnated over recent years. Only Thailand and Vietnam have experienced a significant increase in German direct investment in recent years, while overall investment in Vietnam remains relatively low.[13] In China, on the other hand, German direct investment flows reached a new record high of 11.9 billion euros in 2023.[14]

For many German and European companies, China is currently irreplaceable both as a production location and as a huge sales market. There is a paucity of genuine alternatives to the Chinese economy. Nevertheless, many companies need to geographically diversify their own markets, manufacturing locations and supply chains in addition to their business in China in order to

**Fig. 4: German Foreign Direct Investment Stocks in Billions of Euros**




Source: own illustration based on Deutsche Bundesbank 2023, n. 13.

avoid a one-sided focus and thus dependence on the Chinese economy. In addition to the political aspects, this kind of China+1 strategy seems particularly urgent in light of the deteriorating market environment in China itself. German and European companies are increasingly called on to look for new markets outside of China so as to generate additional growth. The Emerging ASEAN could play a key role here.

### The Potential of the Emerging ASEAN for Production Locations and Markets

The Emerging ASEAN is geographically located on some of the world's most important trade routes and in close proximity to major markets in the Asia-Pacific region such as Australia and Japan. In addition to the RCEP, the countries are also members of a number of other regional and bilateral free trade agreements. This could make these countries ideal for companies as regional production centres from which to serve regional markets outside China. What is more, with a population of around 596 million people[15] and a growing consumer-oriented middle class, the Emerging ASEAN itself is becoming increasingly important as a sales market. A closer look at the economic data of the five countries[16] shows that a China+1 strategy focusing on the Emerging ASEAN could provide many opportunities for German and European companies, while also presenting major challenges.

**Malaysia** stands out as the best performer across all categories in the regional comparison, and usually by a wide margin. Wages in Malaysia are almost one third lower than in China in the manufacturing sector, yet Malaysian workers have a higher annual productivity level per worker at 24,861 US Dollars.[17] Malaysia's economy is well developed, with a technologically advanced industry, a relatively well-educated and productive workforce, and, by regional standards, solid framework conditions for foreign companies and investors. Malaysia is also an attractive sales market due to its relatively high income level. Although the country is comparatively small with a population of around 34 million, it probably has the most potential in the short term with regard to the diversification efforts of primarily high-tech European companies.

In the long term, however, **Vietnam** could become the country with the greatest diversification potential. Although Vietnam currently ranks at the bottom in most categories of regional rankings such as productivity, per-capita income and infrastructure quality, it has made great strides in almost all areas in recent years and even partially outpaced countries such as Indonesia and the Philippines. A major advantage for Vietnam is its cheap yet well-educated workforce, coupled with rapidly improving industrial competitiveness. Moreover, Vietnam's 2019 free trade agreement with the EU makes it particularly attractive for European companies compared to its Southeast Asian neighbours without such agreements.

> **Indonesia and the Philippines can boast dynamic economic growth.**

**Thailand** is still performing relatively well in most categories compared with the other Emerging ASEAN countries, yet a closer look at the data suggests that the Thai economy is increasingly living off its capital. At around three per cent, economic growth is too low for an emerging country, and key economic indicators such as productivity, industrial competitiveness and income are stagnating at a low level. General conditions for investors, such as the high level of corruption, also pose a challenge. Thailand's population is already ageing and shrinking. Thailand is therefore at risk of becoming a "grows old before it gets rich" country.

**Indonesia** and the **Philippines** can boast dynamic economic growth and a large and growing labour pool due to demographic change. Despite labour costs in both countries being very low by regional standards, unlike in Vietnam, the workforce is relatively poorly educated and therefore not very productive. In rankings such as PISA or the World Bank's Human Capital Index, Indonesia and the Philippines fare worst in the regional rankings. However, with a population of more than 275 million and a rapidly growing middle class owing to rising incomes, Indonesia has a huge sales market that makes the country attractive as a regional production hub for foreign companies. Indonesia is also one of the largest producers of raw materials such as nickel, cobalt and copper, which are crucial in the context of the global energy and mobility transition. However, both countries exhibit relatively challenging regulatory environments, and their high levels of legal uncertainty and corruption could deter foreign investors. The Philippines and Indonesia in particular also have extensive protectionist rules and measures, such as high tariffs, non-tariff trade barriers and complex import regulations and procedures.

The Emerging ASEAN can and must play a key role in the China+1 strategies of German and European companies. After all, the Emerging ASEAN has the world's most dynamic growth rates and a growing, young and increasingly affluent population. Compared to other emerging countries and economic regions, it still offers the best potential for diversification of production and sales markets away from China, despite all the challenges.

**The Emerging ASEAN are increasingly willing and able to let the negotiations fail.**

### The EU's Trade Negotiations with the Emerging ASEAN

The EU must finally conclude its trade negotiations in the region so that European companies can truly harness the potential for diversification in the Emerging ASEAN. While the EU signed a free trade agreement with Vietnam in 2019, negotiations with Indonesia, Malaysia, Thailand and the Philippines, some of which have been ongoing for years, have made little progress. The main obstacle to successfully concluding negotiations is the EU's efforts to impose non-trade


More of this, please! In 2019, Vietnam and the EU signed a free trade agreement. Although agreements with the other Emerging ASEAN states are urgently needed in view of European diversification efforts, Europe has so far overloaded the talks with non-trade issues. Photo: © AP, picture alliance.

demands, such as extensive labour and environmental standards, as part of the negotiations. Countries such as Indonesia reject this approach and accuse the EU of protectionism under the guise of climate protection and human rights.

The countries of Southeast Asia themselves have a strong interest in closer political and economic cooperation with the EU, particularly when it comes to counteracting their own growing dependence on China. According to the annual "The State of Southeast Asia" survey[18] of around 2,000 experts and decision-makers in the region, the EU is still viewed as the favoured partner with a view to hedging the rivalry between the US and China. However, the survey also shows that Europe's influence in the region is markedly declining and that the role of countries like Japan, Australia and South Korea is gaining importance alongside the two major powers. Economically, the importance of countries such as India, Qatar and the United Arab Emirates is also on the rise.

In light of growing global economic interest in the region and the current stagnant trade with the EU, the Emerging ASEAN countries are increasingly willing and able to walk away from trade negotiations with the EU.[19] For the EU, this would be a significant setback both in terms of Europe's diversification efforts and its already declining geopolitical influence in the region. The EU needs the ASEAN states to achieve its ambitious goals in areas such as global climate protection, the reform of multilateral trade rules or the protection of free and open trade routes.

The EU should no longer overload trade negotiations with non-trade demands and instead decouple such issues, where they are not directly trade-related, from trade policy issues. The EU has other instruments for supporting social development or climate protection in the Emerging ASEAN countries. The main instrument is undoubtedly the Global Gateway Initiative, within the scope of which the EU plans to invest ten billion euros in green transformation and sustainable connectivity in the ASEAN countries over the next few years.[20]

It is also essential for the European Commission and the German government to ramp up their support to European companies striving towards diversification in Southeast Asia. The German government's introduction of favourable conditions for taking over investment guarantees in countries with high diversification potential in October 2023 was a step in the right direction. Moreover, political support for the engagement of European companies in the Emerging ASEAN should be expanded. The number of high-level political visits from the EU to ASEAN countries could still be significantly increased. As with similar visits to China or India, high-level political delegations to the region should also be accompanied by high-level business delegations.

The Emerging ASEAN is becoming more confident given its dynamic economic development and the increasing global interest in the region. The ASEAN countries expect the EU to pursue a genuine partnership-based policy. For them, Europe is now just one option among many, and in the region's capitals, patience with an EU perceived as morally arrogant is wearing thin. Europe needs the emerging economies of Southeast Asia if it is to reduce its economic dependence on China. This is why the EU should adopt a more pragmatic approach. Europe will not be successful in ASEAN by wagging its finger and insisting on European standards. Countries like China and the US, but also Australia, Japan, South Korea and India are queuing up to work with the Emerging ASEAN countries – and Europe increasingly risks being left behind.

*– translated from German –*

*This article is based on the author's May 2024 study published by the Konrad-Adenauer-Stiftung: De-risking, but where to? The Emerging ASEAN countries as an alternative to China, accessible at https://ogy.de/tbik.*

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Photo: © David Peinado, NurPhoto, picture alliance.

What Will Become of Globalisation?

# Out of the Ashes

## How Mexico Benefits from Global Trade Conflicts – and What This Means for Germany

Hans-Hartwig Blomeier / Maximilian Strobel

When North America is mentioned in Germany, many think of the US, and maybe of Canada. But the fact is that Mexico is also an integral part of the region, economically as well as geographically, and thus perhaps benefits more than any other country from the "trade war" between the US and China. German companies have taken notice, and German politics should quickly follow suit.

The past few years have witnessed grave disruptions in the global economy: trade conflicts, the pandemic, wars in Ukraine, the Middle East and elsewhere, and blockades of central trade routes such as the Suez Canal or the Panama Canal have called the idea of perpetually free global movement of goods into question and prompted structural changes.

In particular, the 2018 trade conflict between the United States and the People's Republic of China initiated in reaction to Chinese trade practices that former and potentially future US President Donald Trump perceived as unfair, resulted in a readjustment of global trade flows and investment strategies and great economic losses, at least in the short term. The repercussions of this are felt by a far larger group of nations than just the direct participants.[1] The German economy, for instance, suffered huge setbacks to its export-based approach even though trade relations with both sides of the trade conflict have remained fairly good. The global economy shrank noticeably, and direct foreign investment declined. Yet some countries, such as Mexico and Vietnam, are now experiencing a significant inflow of investment and foreign capital as part of strategic readjustments.

The outbreak of the COVID-19 pandemic just two years after the trade conflict began suddenly brought all of global trade to a virtual halt. No globalised country could avoid the effects of the pandemic, though countries in favourable financial positions were at least able to temporarily support their economies. Having said that, globally organised value-added and supply chains suffered long-term damage from lockdowns enforced at different times. The movement of goods, especially across the Pacific, suddenly proved to be a significant operating risk. Although global trade in goods recovered surprisingly quickly, some sectors will be irrecoverably affected by structural changes.

Mexico, a country of 128 million inhabitants on an area more than five times as large as Germany, emerged from these unfavourable circumstances like a phoenix rising from the ashes. At the start of the year, there was surprising news that what was once referred to as the "extended workbench" of its neighbour to the north had risen to become the most important trade partner of the US. While China's exports to the United States fell year-on-year by a whopping 20 per cent in 2023 to 427 billion US dollars, Mexico's rose by 4.6 per cent to 475 billion US dollars, making Mexico the largest exporter to the United States.[2]

This is the logical consequence of a development that has been underway for years. The escalating rivalry between the major powers has forced companies that operate internationally to anticipate such risks as a Chinese attack on Taiwan and minimise their effects on corporate business (de-risking). The experiences of the pandemic are instructive here, with one obvious approach being to diversify suppliers and supply chains. In order to avoid trade barriers such as punitive tariffs, companies are moving production facilities near to shore. This "nearshoring" dynamic ocurrs after almost four decades of unbridled globalisation that made China the world's factory and elevated it to the status of world power.[3]

Owing to its geographical location, Mexico is probably the biggest beneficiary of the trade war between the great powers and of the increasingly tense geopolitical situation.[4] As part of the nearshoring trend, billions of dollars in investment flow every quarter into a complex country with immense security and development challenges.[5]

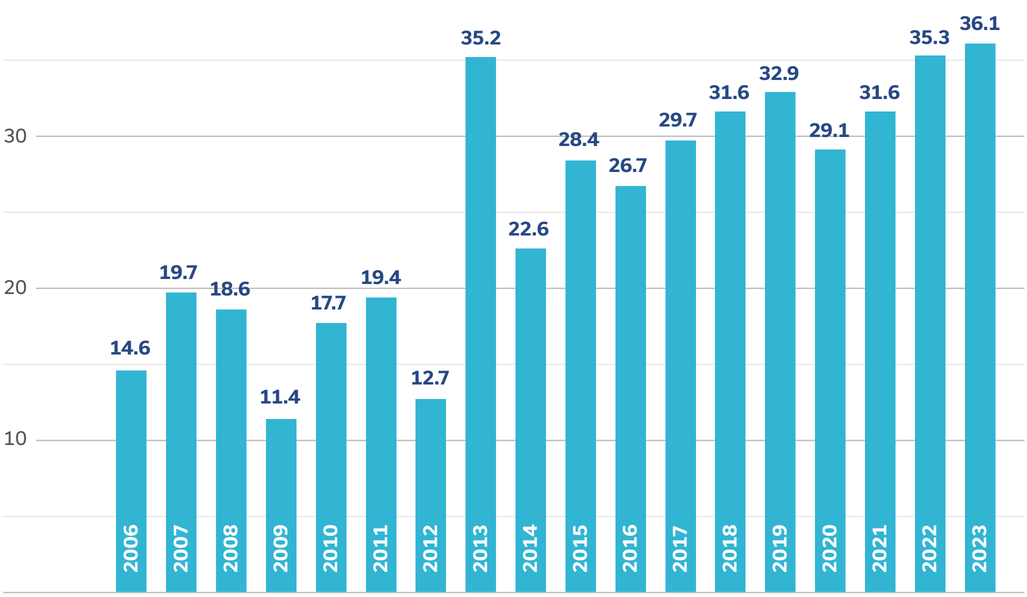
Its 3,000-kilometer-long border with the US is the most dangerous yet the most economically productive border region in the world. Each year, tens of thousands of people are killed or disappear without a trace in the unbridled drug war. At the same time, Mexico is a member of the world's most powerful free trade area.[6] It is also a G20 and OECD nation and is one of the top players in the automotive industry. It remains a country of contradictions, characterised by insecurity and a striking prosperity gap that has no counterpart in any comparably industrialised country.

## Mexico as Part of North America

The histories of the United Mexican States and the United States of America are tightly interwoven with an abundance of conflict as well as economic and cultural interdependencies. In the aftermath of the Mexican-American War (1846 to 1848), Mexico, which had been independent from Spain since 1821, was forced to cede more than half of its territory to the north, and the southern US border was extended to the Rio Grande, where it still remains. Over the next century, the at times interventionist policies of the US in the Western Hemisphere would lead to a division of the New World into two parts: the Anglo-Saxons in the north and everything to the south as their Latin-American "backyard".[7]

Cooperation on equal footing was scarcely desired; instead, Spanish-speaking countries were considered notoriously unstable and incapable of making their own sovereign decisions.[8] It was merely the wealth of natural resources that aroused intense interest from US companies. The Sword of Damocles in the form of possible expropriation of American and British oil companies in the course of Mexican natural resource nationalisation was a source of frequent disquiet in the White House. Not until the triumph of the Cuban Revolution did John F. Kennedy, under great pressure, seek a "new approach" to cooperation with the America south of the US border.

**Fig. 1: Foreign Direct Investment in Mexico (in Billions of US Dollars)**




Source: own illustration based on Gobierno de México, Secretaría de Economía 2024, n. 21.


Tightly interwoven: Specialised clothing for NASA is manufactured in the Mexican state of Yucatán. In terms of exports to the US, Mexico has now even overtaken China. Photo: © El Universal, Zuma Press, picture alliance.

**Mexico's rather protectionist approach was abandoned at the end of the 1980s.**

Despite all the political disagreements, economic and migratory interdependencies between the two neighbours go back generations. Mexico was integrated economically into the North American market in the second half of the 20th century in several stages. In 1965, the Mexican government created an industrial development programme that established *maquiladoras* along the US-Mexican border for assembling sub-products. Duty-free trade with these goods, and the programme itself, put hundreds of thousands of people in structurally weak border regions to work and promoted solid economic growth over the next few decades, especially in the north of Mexico. Nevertheless, Mexican presidents regularly struggled with high inflation, unemployment and national debt. The rather protectionist approach that had been in place was abandoned at the end of the 1980s, trade barriers were dismantled, and Mexico joined the GATT, the predecessor of the World Trade Organisation. Regulations were continually removed in an effort to achieve a free trade agreement with the US and Canada that finally came into force in 1994.[9]

The conclusion of the groundbreaking North American Free Trade Agreement (NAFTA) initiated a process that eliminated duties among the three economies over the next 15 years and created one of the largest trading blocs in the world. The deal met with resistance on both sides of the border: trade unions in the north and farmers in the south fiercely opposed it. The treaty was especially helpful for Mexico when adjusting to the new circumstances of a globalised world over the long term. The country's economy had been fundamentally transformed and it opened up in the following years. Most economists believe that, despite job losses in the US and increased illegal migration from Mexico, NAFTA greatly increased trade volume in North America and thus economic growth and employment rates.

**Mexico, of all places, is supposed to protect its big brother to the north from the pitfalls of globalisation.**

An updated version of the trade agreement, the United States-Mexico-Canada Agreement (USMCA) or Tratado entre México, Estados Unidos y Canadá (T-MEC), came into force in 2020, stipulating, among other things, that cars had to be manufactured at least 75 per cent in North America to be duty-free. This clause is extremely relevant to the nearshoring trend. Global car manufacturers who want to sell their products cheaply on the North American market are forced to increase the proportion of production in North America. This is a key reason for the high foreign investment in Mexico and affects all major German carmakers (VW, Daimler, BMW, Audi, etc.) and their suppliers. At the same time, Chinese companies manufacturing everything from construction machinery to solar modules, and increasingly including carmakers, are moving production facilities to Mexico to circumvent potential punitive US tariffs.[10]

The new version of the free trade agreement must invariably be seen in the context of rivalry with and de-coupling from China. Moreover, the slowdown of global trade due to COVID-19 lockdowns highlighted how just-in-time manufacturing and global supply chains spanning the Pacific Ocean have glaring weaknesses. For instance, Walmart, the supermarket giant, ordered one million work uniforms from Mexico instead of China in 2022. That would have been unthinkable a short time ago.[11]

Given the region's history, there is a certain irony about Mexico, of all places, now protecting its big brother to the north from the pitfalls of globalisation. Racism in the US and arrogance towards Mexicans, who are depicted as backward, are as old as they are well-known. Trump's words, which referred to Mexican immigrants as rapists and drug addicts, went around the world. But he was by no means the first US politician to depict Mexico as a danger to US jobs, security and prosperity. Over the years, many politicians have used Mexico as a scapegoat and threatened to invade Mexico or deport all Mexicans (or Hispanics).[12] This was generally only theatrics, but had real consequences for Mexican immigrants.

Today, it is clear that trade with Mexico is more likely to create and protect US jobs than destroy them. The North American free trade area has merged supply and value-added chains so that they are almost inseparable. Each of the countries in the zone – Canada, Mexico and the US – contributes parts and raw materials that are essential for manufacturing products in each of the others. Cars are the most prominent example: vehicles manufactured in Mexico could not be built without parts and pre-production from the US. About 40 per cent of Mexican exports to the US consist of parts and components originally made in the US. This is true for about 25 per cent of Canadian, but only four per cent of Chinese exports to the US.[13] The Mexican and US economies are virtually interdependent; neither could be nearly as successful without the other. In Germany, there is still a lack of awareness of the implications of this interdependence.

Whoever ends up in the White House is not particularly relevant for trade policy. The US will pursue a protectionist policy if that proves advantageous or if external developments, such as the threatening rise of China, make it appear necessary. Mexico is being propelled by its powerful neighbour and enjoys an exceptionally favourable position thanks to its geography and membership in the free trade area.

**Mexico Is the Beneficiary of Geopolitical Developments**

Global trends and geopolitical conflicts, some of them independent of one another, are thus moving Mexico increasingly into the focus of the global economy. On top of that, wages and manufacturing costs in China have risen, eroding its key competitive advantage. Despite costs for goods transport across the Pacific having fallen again since the end of the pandemic, it is proving difficult to accelerate delivery times. A shipping container takes about one month to travel from China to the US – and the distance from northern Mexico is a fraction of that, while the price advantage of production in China has dwindled.

> **The government cannot assert its monopoly on the use of force in parts of the country.**

What is more, US President Joe Biden has continued his predecessor's policy of punitive tariffs to strategically contain China. At the same time, he is introducing new protectionist policies such as measures to exclude Chinese technology companies from competition in the US. Such steps are also being debated in Germany and at the European level – with respect to Huawei, a Chinese company, and the expansion of 5G networks, for instance. This is all part of the geopolitical metaconflict from which Mexico is benefitting today.

However, if companies that operate globally are to meet demand professionally, they need reliable supply chains and extensive planning security. Industry is not confident that strategic competition between the US and China, with all its secondary arenas, will disappear. If things get serious, excessive dependence on China would prove disadvantageous, so new solutions, suppliers and production locations are being sought. Mexico has the potential to fulfil many of these new requirements. In the industrialised northern territory close to the border, but also in central Mexico, there are states and industrial clusters that enjoy investment by multinational giants such as Tesla and Microsoft and can guarantee the necessary infrastructure.[14]

Even before the advantageous provisions of the USMCA treaty – as early as NAFTA's entry into force – Mexico had developed into a global car manufacturing country. The electromobility transformation is now underway, and Mexico could benefit once again. The state of Sonora, bordering the US state of Arizona, is home to Mexico's largest lithium deposits. They are to be exploited to produce batteries for electric cars and construct solar parks. BMW and Audi plan to integrate production sites in Mexico into their global electromobility networks, and German suppliers are also investing heavily.[15] Beyond that, Mexico's northern states have lots of space and sunlight, which is especially appealing for those companies whose climate and energy requirements have been established by European parent companies.

The issue of renewable energies is just one of the political areas in which foreign presence and corporate investment could have a positive impact on Mexican politics. But this has not been noticeable so far, since outgoing President López Obrador, whose term began in 2018, at least impeded the energy transition, and possibly stopped it altogether. At any rate, the relevance of a green transition was regularly emphasised during the recent presidential campaign by both of the main candidates. Adapting the structures of the energy sector to modern requirements and opportunities would provide further advantages for Mexico as a business location.

But deficits in clean energy are by no means Mexico's only structural deficit. Mexico is also characterised by ruthless, extremely violent drug cartels competing against one another, corrupt political structures, a high degree of impunity and state impotence in the face of complex security challenges. The government cannot de facto assert its monopoly on the use of force in parts of the country. Besides internal security problems, weak rule of law and social inequalities (some 40 per cent of Mexicans are below the poverty line), there are other structural deficits. The 2024 election campaign was also marked by a great deal of violence: candidates were threatened, kidnapped, murdered, or manoeuvred into specific political offices. Hundreds of candidacies were withdrawn in light of these threats.[16] Yet investors and (foreign) companies are not really deterred by these factors because they tend to be located in safer states where industrial infrastructure is already in place. They also engage private security companies for their production plants.

> **Mexico now has its choice of partners and investments.**

President-elect Claudia Sheinbaum, elected by the Mexican people on 2 June 2024, will need to chart a different course to that of her predecessor if she intends to get to grips with Mexico's various challenges. The country's potential has by no means been exhausted. It could pursue a more active industrial policy, courting investment in a targeted, strategic manner to create jobs and generate tax revenue.

It is clear that a new stage in globalisation has begun in recent years.[17] This is not necessarily a process of de-globalisation, which would involve less international trade and less foreign investment. Instead, we are seeing a kind of regionalisation. The North American free trade area; Mexico's geographical and political proximity to the United States, including shared time zones; relatively favourable climatic conditions; and the necessary infrastructure all appear to make Mexico the winner of this new stage. It remains to be seen whether Mexico will be able to exploit its opportunities, absorb the influx of capital in an expedient manner and generate sustainable economic growth combined with a more equitable distribution of wealth.[18] This could also be a key to improving Mexico's security situation.

### Is Mexico Germany's Partner, or Is Germany Mexico's?

From a German perspective, the question is how to harness the opportunities that are now presenting themselves and how attractive a partner it is to Mexico. Simply picking up the phone is no longer enough – Mexico now has its choice of partners and investments.

The sociocultural and economic relations between the two countries are highly favourable. German companies enjoy an excellent reputation in Mexico. This is especially true of car manufacturers, but many other medium-sized companies are popular employers there. Mexico is home to all the big names in German industry. In all, more than 2,100 German companies provide hundreds of thousands of jobs in Mexico and greatly contribute to its socio-economic development. Besides car manufacturing, key industries include chemicals, mechanical engineering, logistics and pharmaceuticals.

For Germany, Mexico is the most important trade partner in Latin America, and for Mexico, Germany is the most important trade partner in the EU. In 2023, the volume of trade was more than 29 billion euros. The previous year, it was 25.5 billion, and in 2021, 21 billion – so there is a clear upward trend.[19] For the German economy, Mexico is an attractive export market (ranking 20th out of 239 in 2023[20]) and the most important investment location in Latin America. In 2023, seven per cent of foreign investment in Mexico, or almost 2.4 billion US dollars, came from Germany, which was the fifth-largest investor after the US (38 per cent), Spain, Canada and Japan.[21]

Culturally, relations on both sides are characterised by multi-faceted family ties due to emigration in both directions going back more than 150 years, when German-speaking families settled in Yucatán. At the beginning of the 20th century, Germans settled on coffee plantations in Chiapas. Beyond that, there is great interest in the German language, as evidenced by the 5,000 students attending five German "encounter"

A rare sight: German President Frank-Walter Steinmeier (left) during a state visit to Mexico. Usually, it is Mexican politicians who make the trip to Germany. The last visit to the North American state by a German Minister of Economic Affairs took place shortly after the turn of the millennium. Photo: © Carlos Tischler, abaca, picture alliance.

schools. According to the German Federal Foreign Office, some 3,600 Mexicans are currently studying in Germany.[22]

At a political level, relations are somewhat cooler. There are various reasons for this, but it is not an acute new development. Because of its size in terms of area, population, economy, culture, resources and biodiversity, Mexico is a regional player of outstanding importance. In Germany, on the other hand, there is often the impression that Mexico's hybrid status (not South America, not the US) prevents the country from attracting the attention it deserves. For decades, politicians have done very little to change this.

An example: the last visit by a German Federal Minister for Economic Affairs to Mexico was in 2002. Over the past 25 years, Mexican presidents, with the exception of the one currently in office, have visited Germany at least once, many of them twice, during their six-year term of office; German chancellors have visited Mexico much less frequently, however.[23]

What is more, there is the geostrategic level as outlined above. If growing systemic competition requires a search for trade partners who share the same values, as is so often emphasised, Mexico is an ideal candidate for closer cooperation – but political efforts in this regard still fall short of the mark. The discrepancy between words and actions in German policy is striking.

**The German government would be well-advised to view Mexico as a strategic transatlantic partner.**

The missed opportunities of the West in Latin America have become clear to see over the past 15 years. One country after another has succumbed to Chinese overtures in the form of low-interest investment in infrastructure projects without onerous environmental or human rights standards. Many countries in the region have welcomed Beijing and fallen into debt traps resulting in long-term financial dependency. Some governments are also closely cooperating on security, buying armaments and surveillance technology, or allowing China to manage their natural resources and critical infrastructure.[24] Authoritarian states such as Cuba, Nicaragua and Venezuela are especially reliant on support from Beijing (and Moscow). But partners of the West, especially Brazil, Chile and Argentina, are also massively dependent on China as a market for their goods and raw materials or as a creditor.

Mexico will not let it come to this due to the proximity and omnipresence of the United States. German and European policy therefore have excellent opportunities to deepen relations with Mexico fruitfully at various levels:

- Now that elections in Europe and Mexico have taken place, the German federal government could lobby in Brussels for a renewal or renegotiation of the **EU-Mexico Global Agreement**.[25] A renewed treaty was renegotiated in 2018 but shelved without ratification. The recent parallel elections on both sides offer political momentum, but Europe would need to scale back its overly comprehensive values agenda on trade issues to a more realistic level.

- Germany should expand economic cooperation with Mexico and design a **more active economic foreign policy** worthy of its name. German companies are very active in Mexico and have good contacts and access to business and politics. Billions in investment by the private sector must be supported and accompanied by **political presence and improved framework conditions** (legal certainty, internal security, infrastructure). This must not be limited to the automotive industry. Investment from Mexico should be equally facilitated, as should market access for companies in Germany.

- The German federal government would be well-advised to broaden its perspectives and to view Mexico as a **strategic transatlantic partner**. New forms of political cooperation should be initiated and existing formats expanded. The following areas are examples of where this could take place:

  - Renewable energies, but also LNG (liquefied natural gas);
  - Environmental and climate protection;
  - Education and research (dual vocational training, the German Academic Exchange Service, etc.);
  - Foreign and security policy.

- Primarily, the German federal government should deepen cooperation at government level, especially in **meetings of the heads of government** and important departments; a visit by the Chancellor to Mexico in connection with the conclusion of an industrial and cultural treaty would (unlike recent trips) be in line with the government's adopted strategies. In the medium term, consideration should be given to **institutionalised intergovernmental consultations** with Mexico.

- In the area of foreign and security policy, a **security dialogue** with Mexico about questions of international conflict resolution, participation in UN peace missions and the future of multilateralism could deepen relations between the two countries and give

Mexico a more active role in the international arena again.

- There are also points of cultural linkage such as book fairs in Guadalajara, Leipzig and Frankfurt; the 2026 FIFA World Cup, of which Mexico is a co-host; and increased funding for university exchange programmes.

**Conclusion**

No analysis of Mexico can fail to include the quote attributed to President Porfirio Díaz Mori (1830 to 1915): "Poor Mexico, so far from God and so close to the United States." Will its geography finally prove to be a blessing?

An extraordinary combination of global developments and geopolitical conflicts has enhanced Mexico's trade policy hand. It now holds many trump cards, and it could further improve its position with solid investments in infrastructure and policy. Mexico has long ceased to be a developing country. Instead, it is now an industrialised aspiring regional power in the heart of the Americas that is highly attractive to many industries in times of nearshoring.

The political players in Germany and the EU have failed to fully recognise the signs of the times, even though these signs have been repeatedly emphasised. The classical categorisation of Mexico as part of Latin America does not fully reflect reality and inevitably leads to misjudgement. Geography must be taken note of. There are 7,500 kilometres between Mexico City and São Paulo. That is twice the distance between Helsinki and Lisbon. Visits to the Brazilian rainforest or to Buenos Aires may reach the big players in South America, but inexcusably exclude Mexico. This will neither make Mexican politicians nor the people feel as though they are taken seriously by Europe and its leaders.

Officials in Berlin and Brussels must learn to understand that the USMCA free trade agreement has made Mexico geographically, economically, socially and politically de facto a part of the economic giant that is North America. For comparison: in 2023, the European Economic Area (EEA)[26] generated only 18.14 per cent of global GDP, while the US, Mexico and Canada generated 29.59 per cent.[27]

If the West, the EU and the German federal government are really hoping to win allies that share their values as strategic partners in the context of global systemic competition, they must take significant action and make political and economic investments. Mexico is ready, but will not wait for Europe forever.

*– translated from German –*

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What Will Become of Globalisation?

# From Conflict to Connectivity

## On the "Silk Road" of the Gulf States

Philipp Dienstbier / Nicolas Reeves

With ambitious infrastructure projects, the Gulf states are establishing themselves as a central bridge for trade flows between East and West. Saudi Arabia and the United Arab Emirates in particular seek to exploit their strategic position between the continents of Africa, Asia and Europe to make the leap into the post-oil economic era. But not only economic hurdles stand in the way – regional conflicts and geopolitical rivalries threaten to throttle the "Silk Road" of the Gulf.

"This is a real big deal!"[1], announced US President Joe Biden as he and the heads of government of Germany, the EU, France, India, Italy, Saudi Arabia and the United Arab Emirates (UAE) agreed on an economic corridor from India via the Gulf states to Europe at the September 2023 G20 summit in New Delhi. The India-Middle East-Europe Economic Corridor (IMEC), a network of ship and rail connections, power lines, fibre optic cables and pipelines to transport hydrogen, intends to promote the transformative integration of South Asia and the Middle East, including Israel.[2]

Like a spider in a web, the two economic powerhouses of the Arab world, Saudi Arabia and the UAE, are located at the crossroads of this important planned trade route between Asia and Europe, which holds the potential to present a significant alternative to China's Silk Road (Belt and Road Initiative, BRI). Through leveraging their advantageous geography, the Gulf monarchies seek nothing less than to become the central bridge for trade and financial flows between East and West.

**Of Wars and Container Ships**

IMEC is part of a larger approach by the Gulf states to lead their economies into a post-oil era. Connectivity projects form a key pillar of the Gulf region's economic transformation plans – the so-called Visions. No longer do the Gulf states intend only to become a hub for world trade. More than this, Saudi Arabia and the UAE in particular aim to attract increasing shares of global supply chains, thus providing a boost to domestic economic growth. To accomplish this goal, the Gulf monarchies have come to rely on state capitalism and government intervention in the economy on an unprecedented scale.

This also has political implications. The economic "Visions" go hand in hand with an ambitious plan for the region that focuses on stability, de-escalation and a secure economic environment. Whether the Abraham Accords between Israel, the UAE and other Arab countries, the rapprochement between Saudi Arabia and Iran or Riyadh's interest in normalisation with Tel Aviv – these are all essential building blocks of the economic strategies of the monarchies of the Arabian Peninsula.

At the same time, the states of the Gulf Cooperation Council (GCC) are diversifying not only their trade relations, but also their foreign policy. While the West sees IMEC or the European Global Gateway initiative as competitors to China's BRI, the Gulf states, especially Saudi Arabia and the United Arab Emirates, view them as complementary. Participating in everything is part and parcel of the Gulf's international economic policy; to the GCC monarchies, economic entanglement is a means to reinforce their own geopolitical position. Saudi Arabia and the UAE, for example, are BRI signatories alongside their association with IMEC. Riyadh belongs not only to the G20, but is also in the process of joining an expanded BRICS group together with Abu Dhabi.

Still, despite great visions for the future, the Gulf has yet to escape the ghosts of the past.

Hamas' attack on Israel on 7 October 2023 and the subsequent war in the Gaza Strip shook the region and with it, the Gulf states' economic integration projects. Less than one month following the announcement of IMEC, the dream of an infrastructural miracle in the Middle East already seemed to have shattered. Not only new, but also old trade routes suddenly came under threat. With relentless attacks on merchant ships passing through the Bab al-Mandab Strait off Yemen's coast, the radical Islamist Houthi militia brought 15 per cent of global trade to a standstill. To the same extent that the Gulf states harbour great potential as hubs for global transit and trade, so too does regional instability threaten this status.

### First Dubai, Then the Rest: The "Visions" across the Gulf

The establishment of a "Silk Road" across the Arabian Peninsula aligns with the goal of Saudi Arabia, the UAE and their GCC neighbours to diversify the Gulf as a business location, develop non-commodity-based industries and make national economies less dependent on oil and gas. This diversification process began in the UAE, where Dubai quickly became the pioneer of rapid economic change on the Arabian Peninsula.

The Emirates announced their national "Vision" back in 2010. Directed by its architect, Sheikh Mohammed bin Rashid Al Maktoum, Ruler of Dubai and Prime Minister of the UAE, "Vision 2021" primarily diversified Dubai's economy. The emirate successfully established itself as a hub for trade, logistics, business and finance – yet others have long attempted to follow suit.

For several years, the neighbouring Kingdom of Saudi Arabia has been emulating the UAE's example of success. Saudi Crown Prince Mohammad bin Salman Al Saud announced his "Vision 2030" in 2016, one of whose aims is to open up the country's economy to forces of globalisation and develop the kingdom's tourism and logistics sectors in order to attract multinational companies and, ultimately, high-tech industries.

**The Gulf states are mobilising massive amounts to achieve their ambitious goals.**

Riyadh thus seeks not only to become a centre for global trade, but above all to bring more links of the world's supply chains to the country, thus pulling larger portions of processes of value creation onshore. With the help of modern technologies, highly developed ports, railways and roads are to contribute to the import of intermediate products to the Gulf states in the future. Once brought ashore, they will be processed and ultimately exported as high-tech end products. The kingdom has already achieved initial success in this regard, having become the host of advanced industrial production processes for products ranging from electric vehicles to defence equipment.

Despite this progress, the economic goals of the Gulf states appear overly ambitious. To fulfil the crown prince's vision, Saudi Arabia's oil-adjacent economic sectors would have to grow by nine per cent each year until 2030. So far, however, they have only achieved an average annual growth rate of 2.8 per cent.[3] For their part, the UAE require a rate of seven per cent per annum to achieve their economic ambitions, yet are forecasted to witness annual growth of only four per cent from 2024 to 2028.[4] The Gulf states are therefore mobilising massive sums to achieve their ambitious goals, highlighted by heavy investment in regional infrastructure for trade, logistics and transport.

### At the Crossroads of Three Continents

From the outset, facilitating connectivity has played a prominent role in the Gulf states' economic transformation projects. Dubai may be known for its grandiose prestige projects, but far more important were the construction of the region's largest deep-water port, Jabal Ali, and a free trade zone whose favourable investment climate has attracted multinational companies to the emirate. While Emirates Airlines achieved worldwide fame, it was the lesser-known state-owned company DP World that brought a string of ports from Hong Kong to London under Emirati control.

**Since 2017, Saudi customs clearance procedures have been reduced from twelve days to two hours.**

This policy established the Emirates as a linchpin for trade routes between Asia, Africa and Europe. In addition to oil, a wide range of products transfer through Jabal Ali, Dubai International Airport and the UAE's many other commercial hubs. The Emirates occupy different roles with respect to these flows. Firstly, they serve as a central gateway for goods, which they in turn export to the region. For example, broadcasting equipment from China, Vietnam and India is the country's second-largest import, totalling more than 20 billion US dollars each year. After arriving in Emirati ports, more than 80 per cent of the goods are re-exported: by land, sea or air, these products reach neighbouring countries such as Iraq (19.9 per cent), Iran (16.4 per cent) or Saudi Arabia (12.5 per cent).[5]

Secondly, the UAE acts as a global hub for key raw materials and strategic goods. The Emirates' international connectivity is particularly important for their largest import product: gold for industrial processing. Over 55 billion US dollars' worth of gold flows into the UAE from the conflict regions of Mali, Sudan and other


Path to a successful future beyond oil? In 2016, Crown Prince Mohammad bin Salman Al Saud announced the "Vision 2030", which aims, among other things, to develop Saudi Arabia into a hub for multinational companies and high-tech industries. Photo: © Bandar Algaloud, AA, abaca, picture alliance.

places of origin, 30 billion US dollars of which is exported to countries like Switzerland, Hong Kong and Turkey.[6] These examples illustrate the close interplay between the Emirates' trade links and the rulers of Abu Dhabi and Dubai's strategy of maintaining close economic and political relations with international partners of all stripes.

This is exactly what Saudi Arabia aims to accomplish with its "Vision 2030". Riyadh strives to imitate the model of the regional pioneer UAE and develop the kingdom into a centre for global trade through investments in the logistics sector. It is no coincidence that the Saudi mega-project NEOM is located at the strategic crossroads of three continents. Here, too, the international furore surrounding extravagant prestige projects, such as a planned futuristic linear city in the desert, overshadows the economic overhaul of less glamorous sectors such as logistics and trade. NEOM, for instance, will also include an automated port and industrial city that will integrate Saudi Arabia into global supply chains along the trade routes passing through the Suez Canal and the Red Sea.

The Saudi seaports of Jeddah and Dammam as well as Riyadh airport also add to the kingdom's status as a pivot for the onward export of goods. For example, Apple opened a distribution centre at King Khaled Airport in Riyadh in 2022, from which 100,000 electronic devices are transported onwards to the Saudi market and other GCC countries each year.[7] Furthermore, annual throughput at Saudi ports increased by some 50 per cent between 2016 and 2023, from 7.7 million containers[8] to 11.4 million.[9]

Next to expensive investments in ultra-modern logistics zones, reductions in bureaucracy have also played a significant role in bringing about these improvements. Since 2017, customs clearance procedures have been reduced from an average length of twelve days to just two hours.[10] The kingdom now ranks 38th on the World Bank's Logistics Performance Index[11], an improvement of 14 places compared to the era before "Vision 2030".

**Connectivity as a Driver of Economic Development?**

Despite such quantum leaps, the Gulf states remain far from achieving their ambitions. While modern infrastructure for trade by air and sea has become widespread, the development of land links between the east and west coasts of the Arabian Peninsula and between the Gulf and its neighbouring regions falls short of the mark. The same applies to the planned pipelines that will export green hydrogen around the world in future. The establishment of an IMEC-style transregional economic corridor hinges on the development of this infrastructure in the coming years.

> **Economic diversification, especially in Saudi Arabia, relies on state intervention.**

Although Saudi and Emirati infrastructure is already among the best-developed in the Middle East, there is still some catching up to do. For example, Saudi Arabia's largest rail infrastructure project – the expansion of the eastern Riyadh-Dammam rail corridor through the construction of a railway line between Riyadh and the western coastal city of Jeddah – has been planned since the 2000s. Implementation, however, only began at the end of 2023.[12] A rail link connecting the GCC states has also been talked about for decades, yet outside of Saudi Arabia and the UAE, there remains a lack of laid tracks (see figure 1).[13]

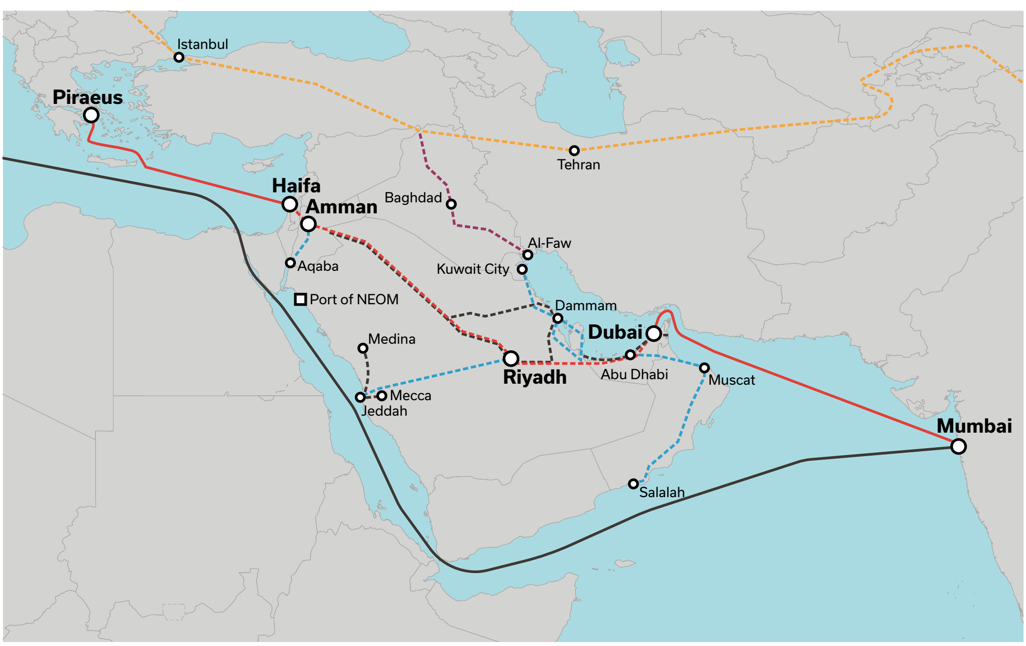
For trade, logistics and transport to become real drivers of growth, the Gulf economies would also need to be financed in a more sustainable and oil-independent way, with greater support from the private sector. However, there are deficits on all these fronts. Economic diversification relies on state intervention, especially in Saudi Arabia. In the kingdom, the largest Saudi sovereign wealth fund, the Public Investment Fund (PIF), almost exclusively drives these developments, having invested some 1.3 trillion US dollars in the country over the past decade. In 2023 alone, the Saudi state spent 20 per cent of the country's gross domestic product (GDP) on inward investments.[14] Even in China, such state investments only amount to around two per cent of GDP.[15]

**The rulers in Abu Dhabi and Riyadh know that economic connectivity requires political stability.**

Owing to the high dependence of state budgets on oil – 41.4 per cent in the UAE[16], 67.6 per cent in Saudi Arabia[17] – this rampant state capitalism also means that the Gulf's positioning as a centre for trade depends primarily on the current situation of high oil prices. In the kingdom, the state-owned oil company Saudi Aramco made the highest profits of any listed company in history in 2022 and 2023, totalling 280 billion US dollars – and directly passed these dividends on to the Saudi state.[18] However, the years since the outbreak of the war in Ukraine have been an exceptional period for energy markets, and it is clear that oil prices will fall again at some point – with knock-on effects for state-financed infrastructure projects in the Gulf. Saudi Arabia recently had to delay its ambitious plans for NEOM due to a lack of alternative sources of funding, and it is likely that the project will have to be scaled down in future, too.[19] To establish their region as a centre of trade and industry between East and West without the support of sovereign wealth and oil revenues, the Gulf States require greater private and international investments in the medium term. However, these depend heavily on the creation of a reliable economic environment.

Whether this will come to pass remains unclear. In 2022, foreign direct investment (FDI) in the

**Fig. 1: Regional Infrastructure Projects and Supraregional Trade Corridors**




Railway line · Planned railway line · Current main route of maritime trade · Trade corridor: Iraq Development Road · Trade corridor: overland section of the Belt and Road Initiative (BRI) · Trade corridor: maritime section of the India-Middle East-Europe Economic Corridor (IMEC) · Trade corridor: overland section of the IMEC · City · Significant city on the IMEC Source: authors' own compilation. Map: Natural Earth ⓟ.

entire Saudi economy amounted to 28.1 billion US dollars or 2.5 per cent of GDP.[20] According to "Vision 2030", however, this would have to grow to 5.7 per cent of GDP in order to achieve Saudi Arabia's targets.[21] Even the regional forerunner, the UAE, only attracted FDI amounting to 4.5 per cent of GDP in 2022.[22] As a stopgap measure, the Gulf has therefore started to resort to protectionist measures, such as a new law in Saudi Arabia obliging international companies to relocate their regional headquarters to the kingdom if they do not want to be excluded from state contracts. Experience with such experiments elsewhere has shown that they can quickly turn out to be a false dawn.

**Political Implications: From Disruptor to Stabiliser**

While it is not yet clear from an economic perspective whether the Gulf's push to become a world leader in trade will prove successful and lead to economic transformation and sustainable growth, this change is already making itself felt in another way: it has transformed the foreign policy calculations of the Gulf states.

No one is more aware than the rulers in Abu Dhabi and Riyadh that their regional economic policy plans require stability. While Saudi Arabia in particular was anything but conflict-averse as recently as a few years ago, the role of the Gulf states has now changed from "disruptor" to "stabiliser". From Yemen to Qatar, from Israel to Iran, the Gulf monarchies now strive to contain stability-threatening regional rivalries and end ongoing violent conflicts in order to create a more secure economic environment and not jeopardise the implementation of their transformation projects. The Gulf states share this interest in regional stability with Berlin and Brussels.

Less to the West's liking, on the other hand, is the political diversification that has followed the Gulf states' efforts at economic diversification. Related to Riyadh and Abu Dhabi's interest in becoming a linchpin for economic flows between East and West is their desire to maintain connections to all political blocs. Accordingly, they wish to become indispensable in equal measure to the US and India as well as China and Russia, and thus avoid clearly positioning themselves in the great power competition between Beijing and Washington.

> **Saudi Arabia and the UAE are pursuing similar business models and thus increasingly compete with one another.**

This is particularly apparent in the case of IMEC. On closer inspection, the corridor, heralded with great fanfare as a rival project to Beijing's BRI, is closely intertwined with China's involvement in the region. Its final destination in Europe is the port of Piraeus, Greece, two thirds of which has been owned by the Chinese state-owned company COSCO since 2016. China also has a minority stake of 20 per cent in Saudi Arabia's largest seaport, the Red Sea Gateway Terminal in Jeddah. Furthermore, Chinese suppliers are involved in Etihad Rail, whose tracks crisscrossing the UAE will serve as a central axis of the overland trade that IMEC intends to inspire.[23] That the "Made in China" label cannot be overlooked at the ports and railway stations that make up IMEC does not represent a contradiction for the Gulf states; to the contrary, they view this as an insurance policy.

While the Gulf considers a multipolar approach and economic ties to all sides as keys to strengthening its geopolitical position on a global scale, the GCC states seek unchallenged hegemony in their neighbourhood from West Asia to North Africa. Abu Dhabi and Riyadh benefit in this regard from the economic weakness of other regional powers such as Egypt and Iran. Both Gulf powers deploy strategic investments to further expand their regional dominance, especially along the Nile.[24]

In doing so, they try to outperform the other competitors. IMEC is in direct competition with the Turkish-Iraqi infrastructure project Iraq

Development Road, which would be bypassed by the Saudi-Emirati corridor. Moreover, the fact that Saudi Arabia and the UAE, as the region's leading economic powerhouses, are pursuing similar business models and thus increasingly compete with one another, could also cause frictions between the two in future. Already, this manifests today in competition between the two over direct investment from multinational corporations and access to markets in their shared neighbourhood.

### The Political Challenges Facing Trade Transformation

However, the greatest risk for Emirati and Saudi attempts to stabilise their neighbourhood and promote regional integration is the Hamas attack on Israel on 7 October 2023 and its ramifications. Negotiations over a possible normalisation agreement between Saudi Arabia and Israel have been shelved since the outbreak of the war in the Gaza Strip. Since Israel's military counter-offensive began, the Gulf region has faced the constant threat of being drawn into the war as a result of Iran and its proxies entering the fray. This catastrophic economic environment has put a drastic damper on intra-regional trade and infrastructure investment.

The ongoing war in Gaza rendered plans for an economic corridor from India to Europe obsolete. As anticipated, the planned meeting of IMEC member states to draft an action plan for implementing the trade corridor was cancelled without being rescheduled. The largest investment vehicle earmarked for IMEC – the G7 Partnership for Global Infrastructure and Investment, which could attract much-needed private investment to the region from a 600-billion-US-dollar pool of capital – has not been activated to date.[25] Only a single framework agreement between India and the UAE has so far been initiated.[26]

Saudi Arabia bears the brunt of economic and political consequences emanating from the renewed instability. The attacks by the Yemeni Houthi militia on shipping in the Red Sea since November 2023 have left deep economic scars: one month before the attacks began, the Red Sea port of Jeddah was the most important entry point into the kingdom, with a record turnover of 511,384 containers[27] and an import share of 28.2 per cent[28]. Since then, the port's contribution fell to 20.5 per cent in January 2024.[29] Over the same period, the kingdom's total monthly imports fell from 19.7[30] to 17.8 billion US dollars[31]. These figures illustrate how quickly regional instability can affect Saudi Arabia's appeal as a gateway to the markets of the Arabian Peninsula.

Despite – or precisely because of – the fundamental threat that the war in Gaza and its regional shockwaves pose to the Gulf states' "Silk Road", Abu Dhabi and Riyadh have responded with a remarkable dual strategy: the construction of a land bridge to Israel, coupled with continued rapprochement with Iran.

**The Gulf powers are not abandoning their strategy of creating stability through rapprochement with all sides, even in turbulent times.**

On the one hand, the conflict paradoxically accelerated the activation of the previously underdeveloped overland route across the Arabian Peninsula as an emergency alternative to maritime trade. Since December 2023, a kind of "mini-IMEC" has emerged between the Gulf states, Jordan and even Israel. The corridor begins in Jabal Ali in Dubai, Mina Salman in Bahrain and the Saudi east coast port of Dammam, which replaced Jeddah as the main gateway to the kingdom in January of this year.[32] From there, lorries bypass the Houthi blockade by distributing imported goods from Asia by land via Saudi and Jordanian roads – even crossing into Israel in some cases. According to industry reports, dozens of lorries use the overland route from Dubai and Bahrain to Israel each day, whose port in Eilat was also cut off by the attacks in the Red Sea, saving 20 days compared to the sea route.[33] Symbolically, this land bridge shows that, despite the tense situation in their neighbourhood, Saudi Arabia and the UAE have not given up on their plans for regional integration involving Israel.

On the other hand, the Gulf states also use their political weight to stabilise their precarious relations with Israel's regional enemies. This trend includes Saudi Arabia continuing its rapprochement with Iran and its policy of détente towards the Tehran-backed Houthi militia in Yemen.


Threat to trade: The attacks by the Houthi militia on shipping off the coast of Yemen are causing serious economic damage and jeopardizing the ambitious plans of countries such as Saudi Arabia and the UAE. Photo: © Indian Navy via AP, picture alliance.

Events like the invitation of Iranian President Ebrahim Raisi – who then died in mid-May of this year – to Riyadh to participate in a crisis summit of the Arab League and the Organisation of Islamic Cooperation on the situation in the Palestinian territories present opportunities for the Saudi government to position itself against Tel Aviv's conduct on the battlefield in Gaza.[34] This reveals that the Gulf powers are unwilling to abandon their strategy of creating stability through rapprochement with all sides, even in turbulent times.

### A More Stable Future within Reach?

The equidistance of Saudi Arabia and the UAE between Tehran and Tel Aviv implies that efforts towards regional de-escalation and stability can withstand the disruption that has spread since 7 October 2023. The Gulf states still believe that a mixture of economic diversification, regional integration and a neighbourhood policy that promotes stability will pave the way towards a brighter future. Even 7 October has not fundamentally changed this.

Nonetheless, developments in recent months emphasise that robust economic connectivity in the Middle East can only be achieved through finding sustainable solutions to the region's conflicts, above all the conflict between Israelis and Palestinians. Europe's role here is not limited to its status as the final recipient of the goods flowing through the IMEC economic corridor. Rather, Germany and its European neighbours could complement the Gulf states' regional political approach by using constructive pressure and diplomacy to steer their close partners in the Middle East away from conflict and towards integration. In contrast to the past, Europe now has sparring partners in the Gulf who share European states' interest in stability and integration for the region. Moreover, Europe's Gulf partners are prepared to invest politically and financially to achieve this objective.

To this end, it is essential that the leading powers in the Gulf maintain an active role in their region, leveraging their influence to bring about rapprochement and stabilisation. Especially in the most consequential and complex conflicts – such as the one in the Gaza Strip – they should take responsibility for finding proactive and pragmatic solutions. Germany and Europe should support them in these endeavours. If they succeed, it is conceivable that future trade flows will not only run undisturbed by ship through Bab al-Mandab again, but also reach Haifa via road and rail from Dammam before continuing their journey through the Mediterranean to Europe.

*– translated from German –*

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Photo: © Rogwan Ward, Reuters, picture alliance.

What Will Become of Globalisation?

# Trade Without Boundaries?

## The Rocky Road to a Pan-African Market

Lukas Kupfernagel

The African Free Trade Agreement has the potential to lead the African continent into a positive economic future. More than 1.2 billion people would be affected, and 54 countries have signed the agreement since 2018. However, numerous challenges prevent rapid implementation. Where is African free trade heading?

The African call for greater autonomy and self-determination can be heard throughout the continent, whether in Algiers, Accra or Addis Ababa. While the slogan "African solutions for African problems" has mainly been used as a statement to curb foreign influence in conflicts, the African Union (AU) has developed a concrete project to bring sustainable prosperity to Africa: the African Continental Free Trade Area (AfCFTA).

As a key component of the continent's Agenda 2063, almost all African countries plan to open their markets to each other over the next few decades, facilitating the easy exchange of goods and services – an ambitious endeavour that would create the world's largest free trade area. However, in the face of multiple crises and a difficult relationship with the role of multilateral organisations on the continent, the first voices are starting to doubt if the agreement will ever be fully implemented.[1] But what is the real status of the African Union's key project? How could its implementation affect the future of the African continent? And what steps are being taken to achieve this goal?

## From Protectionism to Free Trade

Since the founding of the African Economic Community (AEC) in 1991, several member states of the African Union and its predecessor have worked towards greater economic integration on the continent, which is still considered to be the world's worst integrated region. Trade with countries in Europe, the Middle East and Asia has always been more lucrative, especially for the economically stronger African countries. On the other hand, there is a desire for greater African representation in global economic policy issues. Following negotiations in Johannesburg and Kigali, in 2018 all member states with the exception of Eritrea decided to establish the AfCFTA and gradually open their markets to each other. By 2063, up to 90 per cent of customs duties are to be eliminated, trade is expected to create jobs, poverty is to be reduced and Africa is to become a global economic engine. In concrete terms, this means that Africa's cumulative gross domestic product would increase to 3.4 trillion US dollars, income would increase by 450 billion US dollars by 2035 and up to 30 million citizens of the African continent would be liberated from extreme poverty.[2] In the manufacturing industry alone, 16 million new jobs could be created by 2063.[3] In short: the mammoth AfCFTA project is expected to tackle a wide variety of problems.

## The Free Trade Agreement and the Continent's Economy

### *Freedom of Movement*

The African continent will continue to be the youngest in demographic terms for the foreseeable future. With a current average age of just under 19 years[4] and a population growth of 2.4 per cent per year, 4.5 billion people will live there by 2050.[5] This harbours both potential and risks for Africa's economic growth.

It is now clear that the continent's economically stronger countries in particular are experiencing lower population growth, which could lead to a situation similar to that in Central Europe over the coming decades. The fact that well-educated workers from these countries are also emigrating to global economic powerhouses and leaving their home countries is a cause for concern in light of the current "brain drain vs. brain gain debate", although intra-African labour migration might possibly offset this.

**Crime, militias and terrorist organisations still dominate people's everyday lives in some places.**

The example of the European Union shows that a continental free trade area can function more effectively if the free movement of its citizens is guaranteed. Even if the African Union and the regional economic communities cannot ensure this as yet, initial initiatives have already been created in some regions, such as the EAC (East African Community), so as to open up to its citizens a continent with traditionally poor levels of regional integration. Other initiatives, such as Kenyan President William Ruto's abolition of visas in early 2024 – making it the first country to do so – suggest that, despite economic protectionism, a Pan-African sentiment is spreading in some countries which goes beyond anti-colonial debates. Cities such as Nairobi, Cape Town and Accra are already regional melting pots with the potential to become African business and innovation hubs.

At the same time, the risks of the free movement of persons should not be ignored. Organised crime, militias and terrorist organisations unfortunately still dominate the debate as well as the everyday lives of many people in the Horn of Africa, the Sahel and the Gulf of Guinea. The resurgence of the Al-Shabab militia in Somalia and its plans to establish a caliphate in the self-declared "Somali heartland", including parts of Kenya, Ethiopia and Djibouti, through armed violence and attacks financed by smuggling and extortion of protection money, thwart the EAC's current efforts to eliminate visa requirements between its members.

Aside from security policy risks, scepticism and rejection of freedom of movement prevail in some countries, especially in northern Africa. Racist and populist comments by Tunisian President Kais Saied in autumn 2022 and summer 2023 were followed by violent clashes between Tunisians and migrant groups in the capital Tunis and in the port city of Sfax. Similar phenomena were observed in South Africa in 2022, where Zimbabwean and Nigerian citizens in particular were victims of xenophobic campaigns, arson attacks and persecution. Ethiopia, a country of origin, transit and destination for various migration movements, is also trying to cope with the numbers of refugees from the neighbouring Eritrea and Sudan in the face of a more than difficult economic situation.

These examples from North and East Africa show that a lot of work still has to be done in order to harness the positive effects of the free movement of people. For example, in order to drive forward intra-African trade, which is still below average and accounts for only 15 per cent of total African trade,[6] practicable solutions to the challenges should be found.

### *Economic Resilience Through an Innovative Private Sector*

"African solutions for African problems" – visitors to the Ethiopian capital Addis Ababa encounter this slogan as soon as they enter the country at the international airport. In other major African cities, too, such slogans are either immortalised as graffiti or recited like a mantra by leading politicians at international conferences.

Especially by joining the G20, the African Union has set itself the goal of becoming a stronger voice globally, also in order to tackle continental challenges in a more structured way. The creation of a free trade area to strengthen the resilience of African societies is an important step with which the AU could also escape from (financial) dependence on external donors.[7] An African Union that delivers results will also be more attractive to its member states. It increases the chances that the states' membership fees


"African solutions for African problems": With the Free Trade Area AfCFTA, the African Union has developed a project that is intended to lead the continent to sustainable prosperity. If implemented successfully, the largest free trade zone in the world would be created. Photo: © Gabriel Dusabe, Xinhua, picture alliance.

will be transferred in good time, thus also promoting financial independence.

**Interstate conflicts could be contained through closer trade relations.**

Strengthening the private sector and an associated breaking away from the state's tendency to control companies create a new dynamic and "ownership" of one's own destiny. New elites are emerging who are globally networked and bring experience from metropolises such as Singapore, Dubai or New York back to their home countries. Equipped with networks, ideas and the necessary start-up capital, it is now the second or third generation who are investing in their parents' or grandparents' home countries. This is already taking place, but still needs to be actively pursued.[8] The relevance of these players for the future of the continent is illustrated by the fact that the African Union has its own department for diaspora affairs. There is an interest in working for the future of the home countries beyond remittances, but it just needs to break through the encrusted administrative processes; this continues to be a difficult endeavour that must be tackled at both national and continental level. Small but effective steps include the introduction of electronic visas in many countries on the African continent, making it easier for entrepreneurs to travel within Africa. In a report from 2023, the World Economic Forum assumes that it will primarily be young entrepreneurs of African origin who will drive the implementation of the

AfCFTA.[9] At the same time, the continent has been experiencing rising industrialisation rates again since 2010, which is a basic prerequisite for value creation and economic diversification.[10]

Despite all the challenges of a geographical, cultural or linguistic nature, the African Union and the private sector have designed various initiatives to achieve stronger networking between private sector players and entrepreneurs. The Intra-African Trade Fair, for example, affords opportunities to overcome historical borders.[11] A simpler exchange of experience and the possibility to trade across borders with low bureaucratic hurdles still appears to be a utopian dream, but would increase prosperity and create an environment that could react quickly to economic, political and ecological shocks.

The African Union, under the auspices of Commissioner Albert Muchanga, has already launched several consultations and so-called High Ranking Panels to involve the private sector at continental level. Discussions in Nairobi and Gaborone have shown that larger companies in particular see an opportunity for expansion if the institutional framework is right.

**The North-South divide is striking and has become increasingly problematic in recent years.**

*Mutual Dependencies as an Incentive for Peace*

Even if the principle of "change through trade" has been more than just put to the test since Russia's war of aggression against Ukraine at the latest, there is consensus among experts on the African continent that closer trade relations could contain interstate conflicts and reduce the likelihood of new outbreaks of violence. For this reason, more and more initiatives are being launched with the aim of involving the private sector in peace-building processes and of quickly reintegrating conflict regions into trade networks. A common interest in the peaceful use of trade routes would reduce the risk of armed conflicts within and between states. Costs incurred by the parties when conflicts break out would increase dramatically with greater regional integration, making peace and security more attractive, writes the head of the African Union Peace Fund, Dagmawit Moges.[12] On a continent where coups, civil wars and crises have unfortunately made headlines in recent years, greater regional integration through a continental trade policy is a welcome alternative that creates mutual dependencies.

The will of the African Union to see trade as a fundamental component of Agenda 2063 and as the key to the continent's development is evident in the strategy papers and articles of the various institutions. It is now up to member states and AU institutions to break old path dependencies in the nexus between trade and security and find strategies through which greater security can positively influence trade relations, and trade relations can in turn lead to a more sustainable security architecture in individual member states.

*From Regional Integration to an African Identity*

Due to multiple problems, the African Union has been unable to achieve its goal of being perceived as a single entity. Despite some regional economic communities (RECs), such as the West African ECOWAS or the East African EAC, having already been able to record their first small success stories, the overall picture of African integration still looks rather unsatisfactory. The concentration of passenger traffic on a few hubs and, above all, the return to strategies of strengthening national identities are preventing Africa's potential from being fully tapped. The North-South divide is striking and has become increasingly problematic in recent years. Strengthened regional economic communities would provide a vehicle for circumventing established social and economic divisions. Currently, they are often overburdened, but their importance will increase until the AfCFTA is fully implemented, and they will thus be strengthened institutionally.[13]

### What Has Stymied Faster Implementation of the AfCFTA So Far?

Even though the implementation of the free trade agreement remains high on the African Union's list of priorities, the implementation phase got off to a rather slow start. In addition to global challenges that have made implementation more difficult, there are also structural problems that have so far tarnished the prospects of success.

> **State-owned companies often dominate entire sectors, making it almost impossible for the private sector to gain a foothold.**

*The Aftermath of a Pandemic*

The COVID-19 pandemic has hit the African continent hard. The pandemic has further deepened economic rifts within Africa, says analyst Anabel Gonzalez.[14] The start of implementation of the agreement, ambitiously planned for summer 2020, had to be postponed at the time. In addition, the focus has shifted and (reduced) donor funding was redirected to other areas, such as early crisis detection or global health. Closed borders, ports and airports further restricted the already weak trade between African countries.

*The Question of Competitiveness*

Open competition requires a large number of companies, which, driven by the competitive situation, provide the market with a wide range of products or services and need to constantly innovate in order to remain competitive. The problem is that there is hardly any serious competition in many countries on the African continent. All too often, state-owned companies dominate entire sectors and make it almost impossible for the private sector to successfully gain a foothold in the market. At the same time, it is primarily state-owned companies that are often "too big to fail", but have been making losses for years and are a burden on state budgets. Driven by the fear that emblematic companies such as South African Airways could be sold to foreign investors, which would forfeit a piece of national identity, decision-makers are avoiding necessary changes of direction. Meanwhile, the first wave of privatisation in countries such as Nigeria has shown that liberalisation at any price can also be counterproductive and weaken countries in terms of competition.[15] Both the AU and individual member states need to open markets and strengthen the private sector in a balanced way.

*The African Continent – a Geographical, Logistical and Infrastructural Dilemma*

It comes as no surprise that a free trade agreement spanning 30 million square kilometres and 54 countries is no easy task. A total of 15 countries on the African continent have no access to the sea. In some Sahel countries, it is sometimes more than 2,000 kilometres to a port, which means the majority of trade has to be carried out either by road or by air freight. Africa's major rivers are also difficult to navigate for inland transportation, not to mention the deserts and dense forests.

Although the weak trans-African infrastructure is still considered one of the smaller obstacles,[16] it cannot be neglected. One example is the ambitious port project in the Somali city of Berbera, which is seen as an alternative to the port of Djibouti, especially for Ethiopia, Africa's most populous landlocked country. The port project, financed by the United Arab Emirates and operated by the Emirati company DP World, has been completed for some time now, as has the road to the Somali-Ethiopian border – however, the road construction on the Ethiopian side has not yet been completed due to domestic political problems.

The poorly developed infrastructure, geographical challenges, high customs duties and the associated corruption at border crossings have so far driven up logistics costs. Products to be transported from East to West Africa have so far had to be transhipped in the major ports on the Arabian Gulf and shipped either via the Suez Canal and the Mediterranean or around the Cape of Good Hope. Onward transport to landlocked countries is so laborious that logistics companies do not even offer it, or it is so expensive that this branch of trade is scarcely worthwhile. According to the Economist, this is exacerbated by the paradox that retailers often cannot find logistics companies, while logistics companies complain about too much vacancy.[17] The reason for this is the imbalance in trade volumes – too much is being imported (especially from outside Africa), while at the same time hardly any exports are being delivered to the port cities. The market is therefore not very lucrative for logistics companies.

*Free Trade Between Coups and Civil Wars*

After the failed "Arab Spring" that was heralded in 2010/2011 in North Africa, the rise of Boko Haram and the so-called Islamic State in the Sahel and West Africa, and the consistently unstable political and economic performance of many African countries, the 2020s were supposed to mark a turning point and set the continent up for decades of growth. So far in this new decade, however, the African continent and thus

A good reputation: When it comes to trade policy, Germany is well-esteemed in many African countries. The picture shows Chancellor Olaf Scholz with Azali Assoumani, Comorian President and then Chairman of the African Union, at a 2023 summit. Photo: © Liesa Johannssen, Reuters, picture alliance.

also the African Union have been primarily preoccupied with conflicts and coups. Since 2020, there have been more than 15 coup attempts in Africa. The main obstacles to effective continental trade are also smouldering internal and interstate conflicts. In particular, the ongoing problems in the Sahel region, the link between North Africa and Sub-Saharan Africa; the civil war in Sudan; and tensions in the Horn of Africa are currently posing a threat to national implementation strategies for the AfCFTA or blocking trade routes. This is why some experts, such as an employee of the United Nations Economic Commission for Africa (UNECA)[18] and the Nigerian professor Adekeye Adebajo,[19] are now sounding the alarm. The objectives of the AfCFTA are now extremely vulnerable to the ongoing security crises, the increasing number of coups and interstate conflicts.

**The establishment of an African free trade area can only benefit Europe.**

### What Does the AfCFTA Mean for Europe and Germany?

The demand "African solutions for African problems" is clearly formulated and should be taken seriously. The AfCFTA is an African project that should primarily benefit the development of the African continent and be supported by Africans. What is clear, however, is that the successful establishment of an African free trade area can also only benefit Europe, and therefore Germany.

In recent years, the African side has increasingly levelled criticism at European actors and donors, accusing them of pursuing development policies that ignore the interests of the recipient countries. Discussions were also held, particularly in Germany, about whether development policy should be much more strategic and focused on the country's own interests. The AfCFTA is a prime example of how these interests do not necessarily have to diverge. This project could play a key role in the nexus of development, trade and foreign policy.

A harmonised trade policy also means a more reliable basis for negotiations for European companies. A pan-African market ensures more reliable exchange between African and European SMEs. At present, it is hardly worthwhile for European companies to gain a foothold in Africa, since the administrative hurdles are simply too high. On the other hand, African SMEs have hardly been able to establish themselves in Europe. Many of them, such as the coffee industry, are still hoping for bilateral agreements and are suffering from European directives on supply chains. It is obvious that in order to become more competitive (African companies) and remain so (European companies), a compromise must be found. Greater economic integration between the European Union and the African Union would force their decision-makers to engage in such debates.

An economically prosperous African continent would not alter current demographic trends, but it would create new opportunities. Dynamic labour markets and the free movement of people would afford new opportunities to facilitate regular migration between African countries, but also to curb irregular migratory movements within the continent and beyond.

The so-called pre-political space has scarcely existed on the African continent to date. Associations are rarely aware of their political responsibility and only a sporadic exchange takes place between politics and business. This is problematic especially when mammoth projects such as free trade zones and market liberalisation are rarely carried out in consultation with companies. For this reason, the emergence of an active private sector, but above all a pre-political space, should be promoted so as to find innovative solutions to regional, continental and international challenges. In this way, common positions can be developed, the "African voice" in economic policy issues can be strengthened and the new concepts can also be used as an impetus for other regions of the world.

**How Can We Help Shape the Implementation of the AfCFTA and What Is Already Happening?**

A free trade area must always be viewed from both a multilateral and a national perspective, and Germany can provide support in both respects, although the majority of the personnel and financial expenditure must come from the AU member states. At multilateral level, it is a matter of continuing to support the African Union and its institutions and to pursue strategies with them that reinforce their capacity to act. A European approach should be adopted here. This would open up channels for future negotiations between the two institutions, which is in Europe's interest. At a time when multilateral bodies[20] and thus also trade institutions such as the World Trade Organization are fragmenting globally, the will of the African Union and its member states to promote continental integration, at least at trade policy level, is a development that should be supported. In this way, Europe, and Germany in particular, could play a leading role in the long term and find potential new partners to diversify their own trade relations.

What is more, the African continent plays a key role in global systemic competition. From a geopolitical and trade policy perspective, Africa is currently a continent in search of itself and has many options. In addition to Europe, it is the Arab Gulf states, China and Russia that are looking for sales markets, strategic partnerships and influence. In terms of security policy, Europe will play a subordinate role for the foreseeable future. In terms of trade policy, however, it is Germany above all that continues to be highly regarded in many countries and also by the African Union. It should further be noted that the AfCFTA project, even if it is a purely African one, has many parallels with the European Union's internal market and that Europe and Germany are thus natural partners. Therefore, stronger European commitment should also engender an even closer link between the AU as an institution and Europe, and – in contrast to the bilateral relations of African states with France in particular – a stronger positioning of the AU itself as a partner and friend of the European Union.

**It should be clear that building a single market takes time.**

Neither Germany nor the European Union and its companies will play a role in Africa's major infrastructure projects in the future. European companies can rarely compete with prices from the Middle East, Turkey or China and complicated procurement procedures paralyse projects that need to be implemented quickly. It is therefore logical to enter into partnerships with players that are dominant on the African continent at an early stage. These include the United Arab Emirates, which has been one of the most important infrastructure partners of African countries in recent years with a dense network of ports on the east coast of Africa, and Turkey, which now plays an important role – thanks to the well-developed route network of Turkish Airlines and Turkish Airlines Cargo as well as offers that are more in line with markets on the continent regarding price and performance than those of competitors from Central Europe. Clever commercial diplomacy is called for in order to benefit from the structures established by competitors and partners.

It should be clear that building a single market takes time. Member States and their private sectors that joined the EU internal market at a later date can and should also share their experiences with AU Member States and develop forums to advise them on market entry. This would enable EU states without a colonial past to play a more active role in the process and the accusation of "neo-colonialism through the back door" would no longer apply.

At bilateral level, Germany can contribute to advising national AfCFTA committees and preparing member states for the gradual dismantling of their customs duties. Since Germany is already providing intensive institutional support for the implementation of the AfCFTA through the German development organisation GIZ and is the largest donor worldwide, other players, especially think tanks and associations, but also companies, should support the African partners with advice and discussion platforms.

Expecting active support from German SMEs in the form of investment seems unrealistic at present. As the German private sector is generally considered to be risk-averse, all of the above-cited problems would probably have to be resolved before large-scale investments could be made. Nevertheless, SMEs in particular can serve as an advisory player and, if necessary, build the economic bridge between Africa and Germany with joint ventures within a protected framework.

### What We Can Hope for

The AfCFTA is and will remain a flagship project of the African Union and will largely determine the success or failure of Agenda 2063. Decision-makers in Addis Ababa and the member states are aware of this scope. The project is currently still in the embryonic stages and has been set back by the COVID-19 pandemic in particular, although the Guided Trade Initiative has shown initial success. With the idea of reducing customs duties in selected countries and sectors, the AU has certainly proven that it is capable of taking action despite its occasional sluggishness. A recently published study[21] by the Konrad-Adenauer-Stiftung in Ethiopia shows that, despite a bumpy start, the initiative is increasingly developing into a successful project. After eight countries – Cameroon, Ghana, Egypt, Mauritius, Kenya, Rwanda, Tunisia and Tanzania – initially reduced customs duties on 96 products such as ceramic utensils, tea, coffee and dried fruit, a total of 31 countries are expected to have joined the Guided Trade Initiative by the end of 2024.

In addition, national committees help to prepare individual economies and companies for a free market and thus for tougher competition, while new sales markets are also opening up. Together with the AfCFTA Secretariat in Accra, the AU Commission in Addis Ababa and global donors, strategies are being developed, progress analyses carried out and data is being collected in order to adequately prepare for future challenges.

With the start of implementation of the first steps in 2021, we are still at the beginning of a long road towards liberalisation. Nonetheless, important issues such as arbitration, regulations on origin labelling for most products and 45 tariff reductions have already been decided. Most of the rules are to be implemented by 2034 and, according to Brookings, a noticeable effect will not be observed until then.[22]

The road to a successful free trade area involving all AU member states currently seems rocky with a number of conflicts, the inability of some RECs to act, weak regional integration and other issues that seem to be more important than free trade dominating reporting on the African continent and the African Union. However, the success of the Guided Trade Initiative, the willingness of the member states to participate in the process of shaping the free trade area and the need to break through the isolationist barriers of many African states give hope for success. For this reason, we would do well to continue to support this project, which could be a global success in terms of both regulatory and trade policy, with prudence and patience.

*– translated from German –*

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Cover image:
The container vessel Ever Given blocked the Suez Canal for several weeks in 2021. The disruption of the important trade route led to bottlenecks in production for European manufacturers and higher prices for goods from Asia.
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