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Dealing with Global Economic Challenges – An Agenda for the New Federal Government

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OVERVIEW/ÜBERBLICK

Europe

- Germany must once again see itself as an important part of and a leading nation within the EU. The new German government should consistently think and act in a European way on foreign trade issues.
- Only a strong EU single market can compete on equal terms with the USA and China. Together, the EU has strong market power that can be used to counteract trade-restricting measures and enable fair international competition.
- The markets for digital products, financial services and energy are still highly fragmented in Europe. The single market must therefore finally be completed. Furthermore, a strong European market for venture capital, a capital market and banking union is needed.

China

- In the negotiations on countervailing duties for electric cars produced in China, the EU should not engage in sham solutions such as minimum prices or import quotas but should insist on the reduction of unfair subsidies and better protection of European companies against discrimination in the Chinese market. The German government should support the Commission in this.
- Together with the other EU member states and the Commission, the new German government should quickly develop an appropriate regulatory framework to effectively counter threats to national security that may arise from the use of Chinese products in safety-related areas and critical infrastructures in the EU.

USA

- Trump's announced import tariffs on European goods would affect the German automotive industry and other export-oriented sectors. With additional tariffs of 10%, German exports to the US would fall by up to 10% in the medium term.
- The EU's united stance on targeted countermeasures and increased investment in defense in Europe should be part of the strategic response to Trump's unpredictable trade policy. At the same time, Europe should champion openness and liberalization in its relations with the rest of the world.

Trade Agreements

- The EU Commission's plans to conclude trade agreements with regional communities beyond Mercosur should be supported by the German government. The EU's sustainability standards should be adapted to the level of development of the partners to trade agreements.

Africa

- Germany must develop a strategic Africa policy that aims at long-term common interests. Germany should act as a long-term and reliable partner to Africa, taking a leading role within the EU and developing resource partnerships. Migration policy should not aim at isolation but be orientated towards opportunity.

Security of raw materials

- The German government should support the EU's plans for intensive monitoring of the supply situation for strategically important raw materials, intermediate and finished products, and define criteria for security of supply in selected areas, such as antibiotics. In addition, it should promote the research for and development of economically superior alternative products.

European climate policy

- The EU emissions trading system for the transport and building sector should be implemented swiftly and established as a central climate instrument in the long term by adjusting the initial allocation of allowances. CO_2 removal should be supported and corresponding certificates stored for later crediting periods.
- The introduction of the carbon border adjustment mechanism (CBAM) should be maintained, but other trade barriers should be removed at the same time. Developing countries should be supported in collecting emissions data.

Keywords: foreign trade, German federal election, China, USA, Africa, trade agreement, climate policy

Europa

- Deutschland muss sich wieder als wichtiger Teil und als eine der Führungsnationen der EU verstehen. Die neue Bundesregierung sollte in außenwirtschaftlichen Fragen konsequent europäisch denken und handeln.
- Nur ein starker EU-Binnenmarkt schafft Augenhöhe mit den USA und China. Gemeinsam hat die EU eine starke Marktmacht, die eingesetzt werden kann, um handelsbeschränkenden Maßnahmen entgegenzuwirken und einen fairen internationalen Wettbewerb zu ermöglichen.
- Die Märkte für digitale Produkte, Finanzdienstleistungen und Energie sind in Europa nach wie vor stark fragmentiert. Der Binnenmarkt muss daher endlich vollendet werden. Es bedarf eines starken europäischen Marktes für Risikokapital sowie einer Kapitalmarkt- und Bankenunion.

China

- In den Verhandlungen über Ausgleichszölle für in China produzierte Elektroautos sollte sich die EU nicht auf Scheinlösungen wie Mindestpreise oder Importquoten einlassen, sondern auf dem Abbau unfairer Subventionen und einem besseren Schutz europäischer Unternehmen vor Diskriminierung auf dem chinesischen Markt bestehen. Die Bundesregierung sollte der Kommission dabei den Rücken stärken.
- Gemeinsam mit den anderen EU-Mitgliedstaaten und der Kommission sollte die neue Bundesregierung rasch ein geeignetes regulatorisches Regelwerk erarbeiten, um Gefahren für die nationale Sicherheit, die sich aus dem Einsatz chinesischer Produkte in sicherheitsrelevanten Bereichen und kritischen Infrastrukturen der EU ergeben können, effektiv zu begegnen.

USA

- Die angekündigten Importzölle auf europäische Waren würden die deutsche Automobilindustrie und andere exportorientierte Sektoren treffen. Bei zusätzlichen Zöllen von 10% würden die deutschen Exporte in die USA mittelfristig um 10% fallen.
- Geschlossenes Auftreten der EU bei gezielten Gegenmaßnahmen und höhere Investitionen in Verteidigung in Europa sollten Teil der strategischen Antwort auf die unberechenbare Handelspolitik von Trump sein. Sein Streben nach schnellen Deals kann aber auch Chancen bieten. Europa sollte gleichzeitig zum Champion von Offenheit und Liberalisierung gegenüber dem Rest der Welt werden.

Handelsabkommen

- Pläne der EU-Kommission, mit regionalen Gemeinschaften über Mercosur hinaus Handelsabkommen zu schließen, sollten von der Bundesregierung unterstützt werden. Nachhaltigkeitsstandards der EU sollten an den Entwicklungsstand der Partner von Handelsabkommen angepasst werden.

Afrika

- Deutschland muss eine strategische Afrika-Politik entwickeln, die auf langfristige gemeinsame Interessen zielt. Deutschland sollte gegenüber Afrika als langfristiger und verlässlicher Partner auftreten und darin eine Führungsrolle innerhalb der EU übernehmen und Ressourcenpartnerschaften entwickeln. Die Migrationspolitik sollte nicht von Abschottung, sondern von Chancenorientierung geprägt sein.

Rohstoffsicherheit

- Die Bundesregierung sollte das von der EU geplante intensive Monitoring der Versorgungslage mit strategisch wichtigen Rohstoffen, Zwischen- und Fertigprodukten unterstützen und in auch in anderen Bereichen wie z.B. bei Antibiotika Kriterien für Versorgungssicherheit definieren. Die Bundesregierung sollte zudem die Erforschung und Entwicklung wirtschaftlich überlegener alternativer Produkte gezielt fördern.

Europäische Klimapolitik

- Das EU-Emissionshandelssystem für den Verkehrs- und Gebäudesektor sollte zügig umgesetzt und langfristig als zentrales Klimainstrument mit Anpassung der Zertifikateallokation etabliert werden. Die CO_2-Entnahme sollte unterstützt und die entsprechenden Zertifikate für spätere Anrechnungszeiträume gespeichert werden.
- An der Einführung des CO_2-Grenzausgleichs (CBAM) sollte festgehalten werden, aber gleichzeitig andere Handelshemmnisse abgebaut werden. Entwicklungsländer sollten bei der Erfassung von Emissionsdaten unterstützt werden.

Schlüsselwörter: Außenwirtschaft, Bundestagswahl, China, USA, Afrika, Handelsabkommen, Klimapolitik

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DEALING WITH GLOBAL ECONOMIC CHALLENGES – AN AGENDA FOR THE NEW FEDERAL GOVERNMENT

Frank Bickenbach, Eckhardt Bode, Dirk Dohse, Holger Görg, Tobias Heidland, Julian Hinz, Rolf J. Langhammer, Wan-Hsin Liu, Wilfried Rickels, Moritz Schularick [1]

1 Global economic challenges after the election. Why the new German government must think and act European [D. Dohse, H. Görg and M. Schularick]

Preliminary remarks A new Bundestag will be elected on February 23, and the new federal government, which is expected to take office in April, will have to navigate stormy foreign trade waters from day one. This requires a foreign trade compass, and with this Kiel Policy Brief the Kiel Institute for the World Economy would like to provide the future German government with such a compass.

The German foreign trade model in crisis Germany is still one of the big winners of globalization today. The European single market, the common currency and increased trade with emerging economies such as China have boosted economic dynamics and contributed to more growth, prosperity and employment in Germany for decades. However, the *German model*, which relies on open global markets and a fair, rule-based exchange of goods, services and ideas, is currently under threat.

The era of geoeconomics Geopolitical tensions have intensified dramatically in recent years. The rise of China as an economic and technological superpower has led to sharp reactions in the USA and the tensions between the two countries have developed into a full-blown trade war. The covid pandemic and a war in Europe that has been going on for years have significantly impaired international supply chains and shaken confidence in the international division of labor and free global trade. The re-election of Donald Trump as US President, his "America first" policy and his aggressive customs policy are further exacerbating the situation. All of this is contributing to a rapid erosion of the rules-based international trade order, which forms the basis for the success of the German foreign trade model, and is weakening the position of German companies in international competition.

Weak growth and technological backlog The current annual report by the German Council of Economic Experts (SVR Wirtschaft, 2024) shows just how much the German economy has fallen behind in recent years. The manufacturing industry has been hit particularly hard, recording a decline in gross value added of 1% and 0.2% respectively in the first two quarters of 2024 compared to the previous quarter.

[1] The authors would like to thank Alexander Sandkamp and Sonja Peterson for their valuable advice and Michaela Rank for her excellent editorial work.

More recent figures from the Federal Statistical Office even show that gross value added in 2024 fell by 3% compared to the previous year.[2] This is reflected not least in the German economy's flagship sector, automotive manufacturing. While German companies are still dominant in combustion technologies, they have been technologically overtaken and left behind by both the USA and China in the future market of electric vehicles. To a lesser extent, this can also be observed in other sectors: mechanical engineering, for example, is facing the problem that the machines it produces no longer meet demand in China (Stamer, 2023). Overall, the German Council of Economic Experts states that the German economy has lost much of its price competitiveness internationally, and Germany is also at risk of losing ground in terms of innovation in modern key technologies (EFI, 2022).

The solution can only be European Germany can only respond to the aforementioned challenges and the impending loss of international competitiveness within the framework of a strong EU. Together with the USA and China, the EU is one of the three largest economies in the world, and the economies of the EU member states are closely interlinked. Alongside the USA and China, EU countries are Germany's most important trading partners, above all France, Poland, the Netherlands, Italy and Austria. In 2023, almost twice as much was exported to these five EU countries as to the USA and China combined.[3] The big difference between the EU and China or the USA, however, is that the latter have two strong central governments, while the EU has 27 member states that have a say in decisions and also hold different opinions.

European innovation policy and a strong European venture capital market are crucial A strong innovation policy is necessary to increase competitiveness. This must be conceived and implemented at EU level. In addition to a clear strategy, it is particularly important to close gaps in financing. This was also proposed in the Draghi report. Investment in research and development is risky. That is why investors are needed who are willing to take on the risk of supporting innovative start-ups or SMEs, or research in universities. The market for such risk financing, often referred to as venture capital, by state development banks and private investors is still underdeveloped in the EU as a whole compared to other countries. This is partly due to regulatory and tax hurdles, but also because the capital market in the EU is still highly fragmented. This is where the state must take action to facilitate private risk financing within the EU single market and to make investments more attractive for domestic and foreign risk investors by reducing bureaucracy and simplifying taxation.

Europe as champion of openness When it comes to dealing with both China and the USA, action must also be taken at EU level. New and stronger trade agreements with countries such as Canada, India or the Mercosur and ASEAN member states must open up new markets that reduce dependencies on China and the USA on both the export and import side. Trade agreements should focus on trade and de-emphasize other political aspects in order to achieve quick results.

Only a strong EU single market can create a level playing field with the USA and China On its own, Germany is too small economically (and politically) to negotiate on an equal footing with its partners in the USA or China. Together, the EU has strong market power that can be used to enforce measures that enable fair international competition. However, this requires a strong EU internal market, which has

[2] https://www.destatis.de/DE/Presse/Pressemitteilungen/2025/01/PD25_019_811.html

[3] Cf. https://www.destatis.de/DE/Themen/Wirtschaft/Aussenhandel/Tabellen/rangfolge-handelspartner.pdf?__blob=publicationFile

existed for a long time but still needs to be expanded in many areas. This includes not only the above-mentioned need to create an integrated market for venture capital, but also a single market for capital in order to better support investments by innovative start-ups. Last but not least, Germany must again see itself as an important part and one of the leading nations in the EU and think and act more at EU level and less at national level in terms of economic policy.

The fact that the new German government must think and act in European terms – be it in its dealings with China, the USA or the emerging economies of Africa and South East Asia – runs like a red thread through all the following contributions:

China's attack on key industries While for decades Germany has benefited more than almost any other country from China's rise and the dynamic growth of the huge Chinese market, China has increasingly developed into a tough competitor for German and European companies in key industrial sectors in recent years. In their article, Frank Bickenbach, Dirk Dohse and Wan-Hsin Liu point out that China is increasingly using economic power to achieve political goals and to disregard international rules (e.g. WTO rules) to its own advantage. They call for the EU not to engage in sham solutions such as minimum prices or quotas for e-car imports from China in the e-car dispute with China, but to strive for an agreement that includes the removal of unfair subsidies and the protection of European companies from discrimination on the Chinese market. The authors see the development of an appropriate regulatory framework for the use of Chinese products, electronic components and software in security-relevant areas and critical infrastructures as a key task for the new German government and the EU Commission.

Trump's tariff policy: consequences and options for action The re-election of President Donald Trump in November 2024 and his announcement to impose import tariffs of 10% to 20% on European goods pose considerable challenges for transatlantic economic relations. In his article, Julian Hinz examines the policy options available to Germany and the EU. He recommends pursuing a unified and resolute EU trade policy toward the United States, considering the overall trade balance—including the U.S. surplus in services trade—in negotiations, and initiating new discussions on a transatlantic free trade agreement. Additionally, he advocates for a differentiated response to U.S. tariff threats: while non-discriminatory measures can be accepted without countermeasures, targeted retaliatory actions should be considered in cases of discriminatory or economically motivated tariffs—ranging from countertariffs and export taxes to political negotiations. According to Hinz, a coordinated and strategic approach would allow the EU not only to protect its interests but also to emerge stronger from negotiations with the U.S.

Finding new partners with trade agreements In his article, Rolf Langhammer looks at the possibilities of defending the multilateral world trade order. As the GDP losses from a dismantling of the WTO and a possible fragmentation of the global economy would be significantly larger than the losses from a bilateral trade dispute with the USA, Langhammer calls for the German government to use its influence with the EU Commission to ensure that the international trade order is protected if the USA attacks it. Furthermore, the EU should conclude free trade agreements with regional communities such as Mercosur or ASEAN and conclude and deepen bilateral agreements with countries such as India, Indonesia and the Philippines. The dormant negotiations with Australia should be resumed.

Daring more Africa Tobias Heidland's article looks at Africa's future role in the global economy and how the German economy can benefit from intensifying its partnership with Africa. In times of increasing geopolitical competition, Europe needs new partners, and Africa is attractive as a partner in several respects: Africa's young and rapidly growing population offers a huge talent pool, and Africa is rich in raw materials that Germany and Europe lack. In order to exploit the potential of closer cooperation between Europe and Africa, Heidland recommends a partnership of equals that provides development policy incentives for institutional reforms and places education at the heart of development cooperation. He calls for specific legal pathways into the German labor market to be opened up for suitably qualified people, whereby training partnerships in which Africans are specifically trained for the German labor market can play a key role.

Securing critical raw materials Eckhardt Bode's article focuses on securing critical raw materials, which play a key role in the competitiveness of the European economy. The future German government should support the EU Commission in its efforts to reduce Europe's heavy dependence on individual countries such as China, Russia and Turkey. This support should primarily extend to the intensive analysis, monitoring and, if necessary, correction of supply risks along the entire value chains of strategic raw materials, leaving room for market forces and taking into account the economic costs of interventions. However, the quantitative targets set by the EU to expand domestic production, which are receiving particular attention in the media, should be viewed critically and should not be prioritized by the future German government.

Focus on European climate policy Cooperation at EU level is also becoming increasingly important in climate policy, as Wilfried Rickels makes clear in his contribution. Instead of the morally charged focus on "German" emissions, Germany and its partners in the EU should focus on emissions in the European Union. A focus on the European position offers significantly greater leverage in international climate policy and therefore the opportunity to influence an even greater proportion of global emissions through international agreements and trade relations. Accordingly, the new German government should strengthen and consolidate the reasonable European instruments in its international climate policy and, in return, push for the dismantling or abolition of non-market-based and counterproductive overregulation.

2 China's challenges to German key industries: proposals for action [F. Bickenbach, D. Dohse, W.-H. Liu]

Germany and China In recent decades, Germany has benefited more than almost any other country from globalization and China's economic rise. The huge and rapidly growing Chinese market has long been an El Dorado for German industrial companies, and the Chinese economy has been a growth engine for the global economy and an increasingly important trading partner for Germany and Europe.

An increasingly difficult partner The fact that the relationship with China is ambivalent and that China is becoming an increasingly tough competitor in key industrial sectors has become clear at the latest with the "Made in China 2025 (MIC-2025)" strategy published in 2015. The strategy aims, among other things, at massively promoting Chinese companies in ten key technologies such as modern information technologies, electric vehicles and robotics, making them internationally competitive and taking China to the top of the world's leading industrial and technology countries. The rapid rise of Chinese companies such as ByteDance (TikTok), BYD (electric cars), CATL (batteries) and Goldwind (wind turbines) proves that this strategy is having an increasing impact.

Challenge for German companies The MIC 2025 strategy and China's race to catch up in numerous key industries have been perceived as a fundamental challenge to America's global economic and political supremacy, particularly in the US; and trade relations between the US and China have deteriorated continuously since then. Germany and the EU initially played a rather observer role in the trade and technology conflict between the US and China, but European and not least German companies are increasingly being affected by China's striving for technological leadership. A recent study by the Kiel Institute has shown that Chinese companies, especially those that manufacture strategically important products such as electric cars and wind turbines, benefit from massive state subsidies, including at upstream and downstream production stages, which allow them to produce at significantly lower cost than their foreign competitors (Bickenbach et al., 2024). In addition, Chinese companies also benefit from other government support measures such as preferential access to critical raw materials, partly forced technology transfers and preferential treatment in public procurement and administrative procedures.

Hardly any impetus left for German exports Another problem regarding trade with China is that German imports from China are rising almost continuously and the German economy's dependence on imports from China remains high for certain important products, whereas German exports tend to benefit less and less from the Chinese economic growth. According to the latest annual report by the German Council of Economic Experts, the elasticity of German goods exports to GDP growth in China has fallen from more than one in 2010 to almost zero in 2024 (SVR Wirtschaft, 2024), i.e. Chinese economic growth is no longer having any significant positive impact on the German export industry.

What to do

Embracing competition The German / European economy must face up to competition from China: Openness to trade and direct investment, also with China, should generally be maintained. European companies would otherwise risk falling behind technologically and losing competitiveness on global markets, considering the importance and dynamism of the Chinese market, the increasing strength of Chinese research and the innovative capacity of numerous Chinese companies. This is especially true for key industrial sectors such as the automotive industry and green technology sectors.

Defending European interests with determination and unity Policymakers must work more effectively to ensure that international competition is fair. China is an increasingly difficult trading partner that is evidently prepared to use its economic power to achieve strategic political goals and to disregard international rules (e.g. WTO rules). It is therefore important that the EU member states work unitedly on trade policy issues and use the power of the huge EU internal market to negotiate with China on an equal footing. In fact, the EU has recently changed its previously rather passive stance towards China. It initiated an anti-subsidy proceeding against the massive Chinese subsidies to electric car producers, which led to the introduction of countervailing duties on electric cars produced in China (30 October 2024). The response from China has been relatively moderate so far, and negotiations between the EU Commission and the Chinese Ministry of Commerce continue even after the countervailing duties have come into force. In these negotiations, the EU should not agree to false solutions such as minimum prices or quotas for imports of electric cars from China, but should aim for an agreement in which China commits to reducing unfair subsidies and ensuring a more level playing field for European companies on the Chinese market. The current weakness of the Chinese economy and the massive economic pressure exerted on China by the US government are favorable for the EU to reach such an agreement with China.

Reducing critical dependencies It is and remains important for the German economy to reduce critical dependencies on China. This is not about a general "decoupling" from China or about measures that generally make trade and direct investment with China more difficult, but primarily about promoting the diversification of trading partners through trade and investment agreements with other countries or regional groups of coun tries.

Developing adequate responses to growing threats to national security In order to safeguard against potential threats to national security that may arise from economic ties with China, particularly in the area of critical infrastructures, the legal provisions for the screening of foreign direct investments in Germany have repeatedly been expanded and tightened in recent years. A further substantial tightening of the existing legal regulations in this area does not appear warranted at present. However, the risks to Germany's national security arising from the import or use of Chinese products, in particular electronic components and software, in security-relevant areas and critical infrastructures in the EU have not yet been adequately addressed. This is not only about the controversial use of components from the Chinese telecommunications equipment manufacturer Huawei in German/European communication networks, but more generally about electronics and software in infrastructure systems imported from China (such as wind turbines or port cranes) or in connected cars. The US government has already imposed very far-reaching restrictions in this area. In its last week in office, the Biden administration issued a comprehensive ban on relevant Chinese software and hardware for connected vehicles in the US. This ban applies to vehicles from all manufacturers with "with a sufficient nexus to the PRC" (or Russia) and even if these vehicles were produced in the US (BIS, 2025). The new German government should swiftly and in consultation with the other EU member states and the EU Commission examine whether and to what extent the introduction of similar regulations is also necessary in Germany/Europe for reasons of national security and what impact this would have on German/European companies and their production networks. The corresponding reviews and consultations should be carried out with high priority, as such import or usage restrictions will have a huge impact on the investment decisions of both European and Chinese companies in the affected industries.

3 Trump's customs policy: consequences and options for action [J. Hinz]

The re-election of President Donald Trump in November 2024 has once again brought international trade relations into focus. His announcement to impose import tariffs of 10% to 20% on European goods presents significant challenges for transatlantic economic relations.

While tariff threats are sometimes—especially when citing bilateral trade deficits—presumably driven by economic motives, this is not always the case. Since the November 2024 elections, for example, tariffs have also been announced against Mexico and Canada, justified by claims that these countries are not doing enough to curb illegal migration to the United States and the inflow of drugs. The swift implementation of these tariffs was followed just as quickly by a deal suspending them for 30 days in exchange for improved border patrol measures.

A similar pattern emerged in mid-January when tariffs of 25%—rising to 50% within a week—were announced on all Colombian imports unless the Colombian government cooperated in repatriating migrants. In response, the Colombian government reversed its decision to block the landing of two U.S. military planes carrying deported migrants, and the tariffs were dropped. These episodes illustrate a recurring pattern: dramatic tariff threats are often followed by much less spectacular negotiated settlements.

Impact on Germany and the EU

Germany, as an export-oriented nation, would be particularly affected by potential U.S. tariffs. In 2023, Germany exported goods worth more than 150 billion euros to the U.S., accounting for nearly 10% of total German exports—about 60 billion euros more than its imports from the U.S., a trade imbalance that has long been a thorn in Donald Trump's side. The automotive industry is at the center of attention: German manufacturers such as Volkswagen, Mercedes-Benz, and BMW could face significant competitive disadvantages compared to American producers if tariffs are increased.

The European Union (EU) as a whole recorded a trade surplus of 34.5 billion euros in goods trade in 2023, with a bilateral surplus of more than 150 billion euros vis-à-vis the U.S. These economic factors could be a key driver behind the tariff measures.

Additionally, various political disagreements could serve as motivation for tariffs. These include disputes over defense spending levels in the context of NATO commitments, as well as potential future conflicts over policy measures against China, Russia, or other perceived systemic rivals of the U.S.—following the logic of either with us or against us.

Options for action for Germany and the EU

Germany and the EU are by no means backed into a corner or at the mercy of U.S. trade policy. Instead, a coordinated, EU-wide, pragmatic, and interest-driven trade policy can not only mitigate negative effects but also shape developments in a proactive manner:

1. **Strengthen a Unified EU Trade Policy** Germany must insist that trade policy is formulated exclusively at the EU level—and actively uphold this commitment. A unified stance among the 27 member states strengthens the EU's negotiating power vis-à-vis the rest of the world, including the U.S. Unfortunately, past German governments have repeatedly pursued national interests and minority positions, as seen most recently in the tariff dispute with China over electric vehicles, thereby undermining the unity of the EU. While this is not solely a German phenomenon, Germany can set an example by taking a leadership role—for instance, by supporting a position that may seem contrary to its own national interests but serves broader European interests.

   If individual member states prioritize their own interests, it creates the impression that European goals can be undermined through a "divide and conquer" strategy.

2. **Consider the EU's Overall Trade Balance** While the U.S. runs a trade deficit in goods with the EU and Germany, it enjoys a significant surplus in services trade. In 2023, this surplus amounted to 104 billion euros. With the rapid rise of artificial intelligence and digital services in the U.S., this

imbalance may further shift in favor of the U.S. It is therefore crucial to assess the full trade balance rather than focusing solely on goods trade. Moreover, highlighting trade imbalances between individual EU countries and the U.S. within the context of a single market is as misleading as pointing to California's services trade surplus or Texas' and Louisiana's surpluses in oil and LNG exports. Across EU member states and sectors, the trade balance is nearly even, which should be interpreted as economic complementarity between the two blocs and used strategically in political negotiations.

3. **Respond Swiftly and Pragmatically to Tariff Threats** The EU's response to potential U.S. tariffs should be guided by several considerations: (1) If similar tariffs apply broadly to a wide range of U.S. imports, they are non-discriminatory and would not place European exporters at a competitive disadvantage relative to the rest of the world. In such cases, no immediate countermeasures would be necessary. (2) If the tariffs are discriminatory and tied to political conditions—such as in the case of Colombia—alternative solutions outside of trade policy might be feasible. For instance, increased European defense spending or coordinated action against common geopolitical rivals, such as Russia, could serve as negotiating levers. (3) If the tariffs are discriminatory but justified on economic grounds, the EU has several tools at its disposal. These include targeted countermeasures, such as the retaliatory tariffs imposed in 2018 on specific motorcycles (i.e., Harley-Davidson) manufactured in pro-trade Republican congressional districts, as well as countermeasures in the services sector, such as digital taxes or export tariffs. The latter would increase prices in the U.S. without generating inflationary effects in Europe, while affected European businesses could be compensated through tax rebates. Additionally, the EU could engage in targeted negotiations to address specific U.S. demands—such as in the automotive sector. Lowering the EU's most-favored-nation tariff on electric vehicles from 10% to 0% could appeal to Trump's influential advisor, Elon Musk, while simultaneously supporting Europe's green transition. In any case, the EU should act quickly to maintain momentum for a potential deal.
4. **Put New Free Trade Negotiations on the Table** On his first day in office, President Trump not only ordered a review of all trade instruments but also signaled a general openness to new trade agreements. This presents an opportunity to revisit negotiations following the failure of the Transatlantic Trade and Investment Partnership (TTIP). A modern agreement could reduce trade barriers and establish clear rules for both sides. A focus on a traditional free trade agreement that initially lowers tariffs seems particularly appropriate—both because the EU has exclusive competence in this area and because it aligns with the new U.S. administration's trade priorities. A free trade agreement would reinforce rules-based global trade and enhance the EU's strategic autonomy and visibility on the global stage.

The EU Can Emerge Stronger from Negotiations with the U.S.

The tariff policies announced by the U.S. under President Trump pose a significant challenge for Germany and the EU. However, through a coordinated and strategic approach, the EU can safeguard its interests and potentially set new directions for rules-based trade while strengthening its position as a global actor. The transatlantic relationship must be redefined in a way that reflects both current economic realities and shared political values.

4 Finding new partners with trade agreements [R.J. Langhammer]

The defense of the multilateral trade order

It is of strategic importance for the EU to defend the multilateral world trading order and avoid fragmentation. The GDP losses from a decay of the WTO and a possible fragmentation of the global economy would be significantly larger than the losses from a bilateral trade dispute with the USA.

These losses can occur if trading partners react to across-the-board tariff increases by the USA with retaliatory tariffs, triggering escalation spirals and thus destroying the welfare gains that the trade order has been able to achieve for its members in the post-war period. As the most important exporter of industrial goods, Germany would be particularly affected.

The German government must therefore use its influence with the EU Commission to ensure that the trading order remains protected once the USA attacks it. Above all, it must understand developing countries and emerging countries as future growth markets and as the main victims of bilateral trade wars between the three major parties in competition with China. Such understanding can be supported by confidence-building measures such as the unilateral reduction of tariff peaks with a signal character, e.g. on (e-cars and food), the further reduction of subsidies with particularly detrimental effects for the countries (e.g. fisheries), the pursuit of own sustainability goals only jointly with the countries through financial and technical support and by taking into account their economic performance, the support of negotiations on intellectual property rights on genetic resources in these countries as well as financial resources for trade facilitation programs.

Promoting EU free trade agreements with regional communities

The EU sets strong economic and political prerequisites for free trade agreements with regional communities. If only one country in these communities falls short of EU requirements, the EU puts the negotiations on hold. This explains why the agreement with Mercosur remains the only agreement so far and why no agreements have been concluded with ASEAN or other free trade areas in developing countries. This is a mistake. Economies of scale and the possibility of preventing countries such as China from concluding agreements with individual members (see China's advances to Uruguay in Mercosur) are strong cases in favor of concluding early-harvest trade agreements with regional communities (also limited to the manufacturing sector), even if EU political values are still as little fulfilled as the provisions of the exemption rules in Art. 24 GATT on GATT-compliant free trade areas and customs unions, which have been violated by all WTO members in the past.

A future German government should therefore support the EU Commission in its objective of obtaining an approval of the EU Council for the agreement with Mercosur. It should also influence the EU Commission to conclude "early harvest" free trade agreements with ASEAN on industrial goods, as well as with Colombia, Peru and Ecuador, and the Gulf Cooperation Council. The Post-Cotonou Agreement (formerly the ACP Agreement) with the members of the Organization of African, Caribbean and Pacific States (OACPS) should be expanded into a trade agreement and the development policy objectives should be implemented in a partnership agreement separately from the trade agreement.

Concluding and deepening bilateral agreements

The EU can look back on successes in concluding and implementing interim trade agreements, for example with Canada, Mexico, South Korea, Japan, Vietnam, New Zealand and Chile. Negotiations are ongoing with India, Indonesia, the Philippines and Kenya. The suspended negotiations with Australia should be resumed. Bilateral agreements are at the heart of EU trade policy and embody the hub-and-spoke problem with the EU as the hub. Relationships and trade potential between the spokes remain unexploited. This is where the EU needs to make offers to the individual partners in order to raise this potential without giving rise to fears of dominance or falling into the Trump-style approach of asymmetric "deals" based on superiority of power. For many developing countries and emerging markets, easier access to the EU labor market (liberalization of cross-border movement of individual persons) is of particular interest.

In detail, the German government should pursue the following objectives Regulatory institutions of trading partners should in principle consult each other on all planned measures that could affect their trade flows (regulatory cooperation). This cooperation should be used where national sustainability standards and other unilateral measures of a partner differ so substantially that the benefits of the agreements for the partner run the risk of being nullified (e.g. EU Deforestation Directive, EUCorporate Sustainability Due Diligence Directive (CSDDD), EU Carbon Border Adjustment Mechanism (CBAM) from 2026).

Functioning agreements with partners at a similar income level (Canada, South Korea, Japan) and sharing similar values should be examined together with the partners to determine which agreements could also be extended plurilaterally to trade between unrelated partners, i.e. extending the agreements between the EU and Canada and the EU and South Korea to the free trade agreement between South Korea and Canada.

Priority should be given to an agreement with India because this is where the largest obstacles lie due to the different levels of import protection, major fundamental differences in position vis-à-vis the multilateral trading order exist and need to be clarified. This agreement also promises the greatest welfare gains for both sides in view of the weak starting position.

Last but not least, the existing customs union with Turkey was to be expanded to include products such as unprocessed food, coal and steel.

Unity in the EU is a priority

For decades, every German government has been exposed to latent conflict within the EU with partners who give politically influential clienteles such as agriculture a strong protectionist voice in the decision-making process. Political polarization in all EU member states has exacerbated this conflict. Latent conflicts have become obvious, as the controversies surrounding the signing of the EU-Mercosur agreement by EU Commission President von der Leyen in December 2024 have shown. A new German government must be aware that giving in to this conflict would indicate serious disadvantages for Germany. Traditionally important trading partners would be left alone in the event of potential trade wars that do not originate in the EU. The EU would be cut off from access to important export and procurement markets because partners would respond to protectionist measures by the EU with retaliatory countermeasures. In addition, the benefits that the EU could gain from a retaliatory spiral between the US and China could be lost, as EU producers would benefit from trade diversion. And finally, a German government must prevent a conflict within the EU from allowing the US to play a "divide and rule" game by driving a gap between EU member states.

5 Be bolder! How Germany should benefit from intensifying the partnership with Africa [T. Heidland]

A closer partnership creates opportunities Germany's and Europe's economic and political future will largely depend on whether we dare to engage more with Africa. The continent can be important in overcoming Germany's major structural problems. Three are particularly important. Firstly, Germany is experiencing demographic change, leading to labor shortages across nearly all sectors. Unlike in the past, it will no longer be possible to meet labor demands through migration from within Europe (Heidland et al., 2021). Secondly, Germany lacks sufficient natural resources. Thirdly, the global geopolitical shifts put more pressure on the Western system while giving developing and emerging economies more confidence and choice in their partnerships.

Mutual Benefits of Cooperation Germany must assert itself clearly on the international stage and offer potential partners collaboration based on its strengths. It is crucial to understand where German and African interests align: For most African countries, education and jobs for the population, which will grow by almost one billion people to 2.5 billion by 2050 (UNECA, 2024), will have to be a top priority. Germany, on the other hand, relies on immigration to sustain its workforce and would have been shrinking demographically for 50 years without it. Germany lacks raw materials, which Africa has in abundance. Meanwhile, Germany is rich in capital and technological expertise, which are scarce in many African regions. Germany has a well-developed vocational training system, while most African countries need better educational infrastructure beyond basic schooling.

The conditions for stronger cooperation are favorable: Africa is Germany's neighboring continent, historical ties are mostly free from (neo-)colonial burdens, and Germany has built a reputation as a reliable partner in development cooperation and reforms of the international system. As a result, Germany enjoys a high reputation in many places that can be built upon.

Obstacles to cooperation and investment However, there are also obstacles to greater cooperation. For many German companies, the entrepreneurial risks in African markets currently appear too great, and markets are often too small. Even in populous African countries, the middle class is often too small to be a significant consumer market. African economies struggle with excessive bureaucracy, inefficient governance, and poor infrastructure—issues similar to Germany's but on a much larger scale. Unlocking Africa's potential requires massive reforms.

What to do

Germany should focus its economic, foreign, development, and migration policies more strategically rather than spreading efforts too thin. Long-term goals should take precedence over short-term self-interest.

1. **Leading with a constructive foreign policy** In foreign policy, Germany should avoid a short-term, self-serving approach and instead position itself as a long-term, trustworthy partner. Germany must take a leadership role in the EU and the Western world, as the USA and many other Western

countries are failing to do so, at least in the medium term, with Donald Trump advocating for a transactional approach that forces African countries to choose between China and the U.S. This could push African nations away from Western alliances, as China is often seen as a partner that "delivers without preaching." Taking a neocolonial approach would pose great risks for German companies and diplomatic influence in Africa as can be witnessed in the French case. Germany should avoid both mistakes. Partnerships at eye level do not mean one cannot use incentives – quite the contrary.

2. **Strengthen development policy incentives for institutional reforms** In terms of development policy, Germany should more actively promote economic reforms that foster job creation and sustainable growth in Africa. Poverty reduction and a growing middle class can only be achieved through productive jobs. African governments must prioritize economic growth and development and set ambitious targets for themselves. Germany should push more strongly for this. The reform partnerships introduced in 2017 under the German G7 presidency should be used more than in the previous legislative period to create incentives for improvements in good governance and the investment climate. Positive incentives are the means of choice here and should include the following three areas.
3. **Economic incentives for diversification** Many German companies hesitate to invest in Africa due to unfamiliarity, perceived and real risks, particularly small and medium-sized enterprises (SMEs). With Germany's declining long-term growth outlook, incentives should encourage businesses to position themselves strategically in the growth markets of the future. One concrete measure would be closing gaps in risk insurance for SMEs exporting to or investing in Africa. Still, investment flows will remain modest by global standards. In addition, resource partnerships should be pursued, in particular with reform-oriented African countries that thus benefit from investment. German companies can position themselves strategically and long-term in these sectors on the continent and thus contribute to more secure access to important resources. When forming the partnerships, we should ensure that a significant share of the value creation remains in Africa, creating well-paid jobs locally and relieving pressure on the tight German labor market.
4. **Making education and work the focus** For low-income countries to be able to climb to the higher levels of value chains in the long term, it is crucial to place education more strongly in the focus of development cooperation. Co-financing the development of free secondary education and vocational training systems would be particularly suitable to enable significantly broader sections of the population to pursue a medium or highly qualified career. By developing Africa's talent pool, German companies would find it more attractive to invest without relying on large subsidies. To enhance incentives, financial aid should be directed primarily to countries implementing necessary reforms. To incentivize well-performing reformers, they should receive education funds as budget support. This makes sustainable investments in education more sustainable since governments will be unwilling to face conflicts with their electorates over reversing free education.
5. **Focus migration policy on work and education, not on preventing immigration** Migration policy can also be shaped through positive incentives. In political debates, discussions about migration during election campaigns have largely focused on domestic security and the asylum system. While deportations are undoubtedly a necessary part of an effective asylum and migration system, migration policy should not be seen solely as a tool for risk prevention. Instead, it should also be

an instrument for achieving positive effects in economic, development, and foreign policy. Here, too, positive incentives should be the primary approach. Simply threatening to cut development aid if African countries do not cooperate on migration misses the real opportunities that exist. Countries that undertake institutional and economic reforms should, if they wish, be offered partnerships in labor migration. The opportunity to work and live in Europe is an enormously attractive prospect for a significant portion of the African population. This lever should be used to achieve mutual benefits. Therefore, targeted and legal migration pathways should be opened for skilled workers from Africa, tailored to the needs of the German labor market.

Training partnerships and reforming of administrative processes A crucial element of this strategy should be training partnerships, where Africans are specifically educated for the German labor market. Training in Africa should exceed demand, i.e., only some of the trainees go to Germany after graduation, so that the pool of skilled workers in the country of origin grows despite emigration. This approach would prevent brain drain while simultaneously meeting Germany's demand for skilled labor. Initial funding should primarily come from development and foreign trade budgets, but in the medium run the private sector could take over investment—e.g., in healthcare-related jobs. At the same time, there must be a fundamental reform of immigration processes in the German administration. One of the biggest problems for companies that want to hire foreign skilled workers is that these processes are currently dysfunctional. They must be set up so that companies can obtain the necessary documents to hire skilled workers abroad within a few days. This can be achieved, for example, by turning from a risk mentality to an opportunity-driven approach. If companies are prepared to give a person a well-paid job, bureaucracy should be kept to a minimum. For example, to avoid exploitation, administrative checks can be limited to jobs that are not covered by collective bargaining agreements or offered by companies without a good reputation. The visa policy generally needs a reset, as Germany's reputation in Africa and large parts of the developing world suffers massively because not even business people or highly qualified scientists have adequate access to visas. To ensure that the skilled workers who come to Germany stay, it is important that the reforms to citizenship law made in recent years for those people who contribute significantly to the economy and integrate are not reversed.

Germany must dare to engage more with Africa—not with hesitation or fear, but with a clear focus on shared interests, well-designed incentives, and an opportunity-driven approach. Instead of looking southward with concern, we should recognize the mutual benefits of deeper cooperation.

6 Securing critical raw materials: Raw materials policy with a sense of proportion and foresight [E. Bode]

State provision against supply bottlenecks

Strategic raw materials The EU Commission currently identifies 34 so-called "critical" raw materials that are of great importance to the Union's economy and bear pose a high risk of supply disruptions. 17 of these raw materials are classified as "strategic" raw materials because they are considered essential for defence, aerospace, digitalization or decarbonization and are subject to the risk that future global supply will not keep pace with the sharp increase in demand . These strategic raw materials include aluminum, boron, cobalt, copper, gallium, germanium, magnesium, manganese, nickel, platinum group metals, rare earth metals for permanent magnets and silicon. The following recommendations focus primarily on these strategic raw materials and the intermediate and final products manufactured with them.

Assess the damage caused by supply bottlenecks realistically There is considerable uncertainty about the economic and social costs that might be caused by temporary interruptions of imports of strategic raw materials or the products manufactured with them. According to the EU's “Critical Raw Materials Act”, adopted in 2024, raw materials subject to supply risk are to be classified as critical if the goods produced with them account for 2.8% or more of the EU's gross domestic product. This criterion of economic importance overstates the actual economic costs of a temporary supply disruption, however. Unlike fossil fuels, critical raw materials are not consumed directly but are used for the production of predominantly durable consumer and capital goods. An embargo on imports of solar panels or wind mills (or their raw materials), for example, will not jeopardize energy supply. It will merely postpone the expansion of energy production capacities unless it can be circumvented by imports from other countries. In addition to this, production losses during the embargo can be made up after its termination. The long-term economic costs (welfare losses) are therefore likely to be significantly lower than the temporary production losses. Any policy measures to mitigate supply risks should therefore be be evaluated against the expected long-term economic costs of possible supply bottlenecks. However, considerable research efforts are still required to estimate the long-term economic costs of possible supply bottlenecks. The German government and the EU should specifically promote this research.

Intensive monitoring of supply risk urgently required The Critical Raw Materials Act provides for the establishment of a permanent commission for the ongoing monitoring of supply risks.In cooperation with the member states, this commission shall collect and analyze the information required to assess the risks, and proposes mitigation strategies to the EU Commission. Regular stress tests are to provide information on the susceptibility of the economy to potential supply bottlenecks.

The German government should support this thorough national and EU-wide risk management. In particular, governments and private decision-makers need to know (Godart et al. 2023):

- The countries from which domestic companies import strategic raw materials, intermediate products and final products, and what natural, economic or political risks the imports from these countries bear;
- What options exist for diversifying the source countries;
- The extent to which private and public companies have already diversified, or are planning to diversify, their sourcing, and which economic and political obstacles and risks hinder such diversification;
- The extent to which private and public companies hold bufferstocks of strategic raw materials, intermediate products and final products, and how long these stocks will last to bridge temporary supply bottlenecks;
- How vulnerable larger companies in particular are to sudden, unexpected disruptions of imports, and how these disruptions affects downstream stages of the value chains;
- The expected extent of economic and social damage from sudden, unexpected disruptions, and which governmental or private-sector emergency measures are suitable and economically viable to limit this damage.

Some of this information must be collected from individual companies or business associations. While many larger companies have already established their own risk management, reporting obligations could cause considerable additional bureaucratic costs for smaller companies, which can be reduced by selective and automated surveys, and should be reimbursed on a flat-rate basis if necessary.

Government interventions only in response to market failure In the wake of the Covid-19 pandemic and the Russian crisis, many companies have realized import that diversification and extended stockpiling serves as a risk insurance against adverse shocks and justify higher procurement or capital costs. The German covernment and the EU should preferably exploit their various existing programs to support companies' diversification efforts. These include the instruments of foreign trade promotion, the German Raw Materials Fund and the EU's Global Gateway Initiative. Private-sector activities offer no guarantee of a lasting reduction in risks, however. The EU should therefore consider (and communicate) additional interventions only if companies' own efforts are insufficient to reduce supply risks to the extent deemed necessary and economically viable on the basis of the monitoring.

Research funding instead of location subsidies

Quantitative targets of the Critical Raw Materials Act should be viewed critically The German government should attach less importance to the far-reaching requirements of the Critical Raw Materials Act for the expansion of domestic production capacities for strategic raw materials. In particular, the targets for extraction capacities (10% of the Union's annual consumption) and processing capacities along the entire value chain (40%) should be viewed critically. From an economic point of view, there is no fundamental objection to the expansion of domestic capacities for the production of strategic raw materials and products. Even though less bureaucracy and simplified permit procedures could contribute significantly to cost reductions in extraction and production, achieving the EU targets will likely require additional extensive public subsidies.

Public subsidies to expand domestic capacities questionable Whether these subsidies justify possible economic benefits of capacity expansions (reduction in supply risk, achievement of comparative cost advantages) appears questionable. At least for some of the strategic products, Chinese producers currently have considerable cost advantages that are not only due to extensive public subsidies but also to lower labor and energy costs, lower environmental standards, technological advantages or economies of scale. The recent, sobering experience with highly subsidized battery cell or chip factories in Germany also give cause for scepticism. Germany does not need factories that use (more or less) poorly copied Chinese technology to manufacture products that require state subsidies to be competitive.

Focus on Germany's own strengths Germany should rather focus on its strengths, which lie in developing new, more efficient technologies that grant domestic manufacturers a technological lead or use scarce raw materials more efficiently. This can be better achieved through more intensive and targeted support for research and development than through subsidies for domestic production capacities.

7 Focus on European climate policy [W. Rickels]

Focusing on the greenhouse gas emissions of the European Union (EU) rather than German emissions offers significantly greater leverage and the opportunity to influence a larger share of global emissions through international agreements and trade relations. The new German government should strengthen and consolidate the sensible EU instruments in its international climate policy and, in return, push for the dismantling or abolition of non-market-based and counterproductive overregulation. The introduction of trade barriers such as the CO_2 border adjustment should not be established as a fundamental EU position, but should be introduced while simultaneously reducing other trade barriers. An important element is that the Mercosur agreement is ratified quickly by the member states.

Transfer of national CO_2 pricing into the EU ETS2

Support EU ETS2 The future German government should support the introduction of the European emissions trading scheme for the buildings and transport sector (EU ETS2) planned for 2027 and help it to develop into an important, independent pillar of European climate policy after 2030. However, the auction volumes initially allocated to the member states and their national reduction targets differ, as the EU ETS2 is still subject to EU effort sharing regulation until 2030. In the post-2030 design, burden sharing should be achieved by the initial allocation of allowances to member states for auction purposes (Rickels et al., 2024). The new German government should advocate this adjustment and press for the details of the continuation of the EU ETS2 after 2032 to be defined at an early stage. It should also determine how national CO_2 pricing under the Fuel Emissions Trading Act (BEHG) will be transferred to the EU ETS2.

Make use of intergovernmental emissions trading The existing flexibility mechanisms are particularly important under the Effort Sharing Regulation to realize the efficiency gains of the EU ETS2 (Rickels et al., 2024). The new German government should signal its intention to make use of intergovernmental emissions trading already in the coming legislative period in order to compensate for regional shifts in emissions. This would then result in additional fiscal revenue for poorer member states. Nevertheless, a high CO_2 price is to be expected in the EU ETS2 and political pressure to weaken the effectiveness of this instrument. To counteract this, the new German government should work to ensure that the revenue from the auction proceeds and the Climate Social Fund is paid out to citizens in the form of a climate money and that the climate money can be used to service loans for energy-efficient refurbishment measures.

Abolish counterproductive EU regulation In addition, it should advocate political adherence to the EU ETS2 in return for the weakening or even abolition of other small-scale and partially overlapping EU regulation. The Energy Efficiency Directive (and therefore the German Energy Efficiency Act) and the Energy Performance of Buildings Directive are the most suitable options. The former defines absolute energy consumption volumes as a target and therefore does not pursue the goal of market-based efficiency. The availability of large quantities of cheap, renewable energy is crucial for rapid decarbonization. The second will become obsolete if the EU ETS2 is implemented consistently.

Making EU ETS1 and EU ETS2 future-proof

EU emissions trading for the energy and industrial sectors (EU ETS1), which was introduced in 2005, has made a significant contribution to EU CO_2 emissions reductions and is a central element of EU climate policy. However, the rightly consistent reduction of emission allowances will lead to significant price increases before 2030 and thus to political pressure on the ambition level of the EU ETS1. A clear commitment to this instrument is therefore required, as well as proposals on how the EU ETS1 should be continued after allowance issuance expires after 2040 with a view to provide investment security for firms.

Better combination of price and quantity control in the EU ETS1 A better combination of price and quantity control for the period after 2030 is necessary for a future-proof EU ETS1. The current, rule-based mechanisms are not sufficient to stabilize the market against shocks and price speculation with an increasingly smaller amount of remaining allowances. Accordingly, the new German government should press for an examination of the extent to which discretionary CO_2 price management, transferred to an independent institution with a mandate to ensure price stability, is a more sensible design option. Such an independent "carbon central bank" would make European climate targets less susceptible to political pressure. The European Central Bank could serve as a model. A credible mandate for price stabilization, without jeopardizing the net reduction targets, requires the integration of CO_2 removal certificates.

Gradual integration of CO_2 removal into climate policy In order to take the first step towards sequential integration of CO_2 removal into climate policy, the EU could follow the example of the USA and immediately begin to procure CO_2 removal and purchase it within the various technology groups through tenders. Another possibility is for national procurement programs to "pay into" the European reserve. Existing CO_2 abatement procurement programs in Sweden or Denmark could serve as a model for a German CO_2 abatement procurement program. It is important not to use these CO_2 removal certificates to meet the short-term EU climate targets, but to "save" them for later compliance periods.

Price management in the EU ETS2 Price management without jeopardizing the net reduction targets is also required in the EU ETS2. The EU flexibility mechanisms offer the limited possibility of offsetting CO_2 removals through afforestation within the national targets under the Effort Sharing Regulation against emissions in the EU ETS2. For a future-proof EU ETS2, it is necessary to include other natural CO_2 removal methods (e.g. accelerated weathering or methods for marine CO_2 storage) as well as technical options for CO_2 removal and to make their accounting more flexible without upper limits.

Support the implementation of the EU Net-Zero Industry Act In order to achieve the emission reduction targets in the EU ETS1 and ETS2 sectors, the new German government should support the implementation of the EU Net-Zero Industry Act. This includes reducing bureaucracy, carrying out environmental impact assessments at regional level in advance for defined industrial sectors and creating "green" lead markets for low-CO_2 or CO_2-free raw materials such as cement, plastics and steel through public procurement. Last but not least, the Net-Zero-Industry Act also includes the creation of a CO_2single -market and the new German government must both facilitate cross-border CO_2 transportation and contribute to European CO_2 storage capacity.

Adhere to CO_2 border adjustment

The carbon border adjustment mechanism (CBAM) is a useful instrument for curbing carbon leakage. The instrument creates incentives for trading partners to introduce a price on CO_2 emissions and to decarbonize their own industry, as well as to use possible funds from international climate financing for this purpose. Gradual pricing will not start until 2026 and in the first year only 2.5% of emissions in imports must be covered by CBAM certificates. Full coverage is not required until 2034. The new German government should therefore commit to this climate policy instrument, even in the face of possible international opposition. One adjustment option is to slow down the parallel decrease in free allocation and bring it in line with the expiry of allowance issuance in the EU ETS. This would strengthen the competitiveness of domestic companies on export markets. At the same time, tailor-made aid packages should be developed for particularly affected developing countries, such as Mozambique, to help them build up the necessary statistical capacities to fulfill their CBAM reporting obligations.

Keeping an eye on compatibility with long-term targets The new German government should also push for countries affected by CBAM to be more accommodating when it comes to use CO_2 creditoffsets. When making various adjustments to the CBAM or the EU ETS1 , it is important for the new German government to focus not only on the medium-term reduction targets, but also on compatibility with the long-term targets of net-zero and net-negative emissions. For these targets, international trading in CO_2 offsets will become more important as the share of CO_2 removals increases, and the expansion of statistical capacities to map emission flows in the course of CBAM is a crucial prerequisite for mapping the climate contribution of CO_2 offsets.

Minimize bureaucracy and reporting obligations Despite all this, it is important not to accept the geo-economic disadvantages of other instruments if they do not stand up to cost-benefit considerations and are perceived by trading partners as excessive reporting obligations. The new German government should push to minimize the reporting obligations under the EU deforestation directive and the corporate-sustainability directive the Supply Chain Act or (and associated implementing regulations) and advocate alternative solutions, such as a negative list approach to sanctioning foreign companies that disregard human rights or awarding direct payments for forest conservation.

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