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2007 will be an important year for the shape of international economic policy in the decades to come. It is a “make-or-break” time for the Doha Round of trade negotiations in the World Trade Organization (WTO). This has been said many times of the ill-fated effort to liberalise trade that started in the Qatari capital in November 2001. But every time, also after collapses and suspended negotiations, the round has managed to get up on its feet again. Yet this time it looks truer than ever, for the simple reason that the Round is on track to a complete failure. The Trade Promotion Authority (TPA) of the U.S. administration expires in end June and without it proper negotiations cannot be conducted. Nothing to date suggests that the new Democratic leadership in the U.S. Congress will grant President Bush a new fast track authority without a hefty political sacrifice from the White House. The U.S. administration has little political capital to spend on trade affairs and a renewed fast track for WTO negotiations seems even more unlikely considering that the Congress will be asked to pass at least one new Free Trade Agreement – the U.S.-Korea FTA – before the TPA expires.

Yet the problems of this round are not limited to the United States. U.S. trade policy in the last years, also under Republican leadership, has become more complicated and politically sensitive. But there is a trade liberalization *fatigue* in most parts of the world. The Chinese economic-reform programme, the great engine of broad market-economy reforms in the last decades, has slowed down considerably. Indian foreign economic policy seems to have lost the liberalizing guise of the 1990s and retracted to protectionism. The commodity boom has fuelled economic nationalism and authoritarian *beggar-thy-neighbour* policies in several resource-rich countries.

Europe seems stuck in the rut of sluggish economic growth and high unemployment. The general reform inertia has spilled over to internal and external trade policy. The Services Directive passed by the European Parliament before Christmas last year is a limp version of a single market for services. The multilateral zeal in Europe has regressed considerably and the European Commission has had great difficulties in finding a proper leadership role in the Doha Round. A successful outcome of the Doha Round remains the chief ambition of EU trade policy, but this armchair commitment to multilateralism is not reflected in its actual trade strategies. Europe has rather shifted its policy entirely towards FTAs and has recently set targets for negotiating bilateral agreements with no less than 24 countries. This is bilateralism, big time. Regardless the merits of each and every FTA, this exuberant bilateralism will affect the likelihood of a finished Doha Round.

German foreign economic policy

In the face of slowing multilateralism and creeping bilateralism, Germany assumed the chairmanships of the European Union and the Group of Eight (G8). These Presidencies (the G8 Presidency runs for the whole year) are of course entirely unrelated to the broad trade-policy development, but it serves as a great symbol of this era.

Germany is an inexperienced leader for global economic policy. It has a solid trade performance – Germany is the leading world exporter of merchandises and a top-league global economy – but has seldom expressed a considerable interest for multilateral economic policy, global trade policy in particular. Since the end of the Second World War, German foreign economic policy has been distinctly regional in character and its ambitions have been tied to European economic integration. This has been a successful strategy. Regional economic integration in Europe has spurred economic growth. Political integration has followed on its heels and now manifested itself in two successful enlargements of the European Union.

There are remaining issues to address in European economic integration, but from the vantage point of foreign economic policy Germany would stand to benefit considerably more by widening its outlook to other parts of the world rather than keeping an entrenched European focus. German trade performance has stepped out of the Cold War and post-Cold War context. The premier exporting powerhouse in Europe has turned global. But its policy remains closely tied to the Adenauer and Kohl ambitions of European integration.

The German Presidency of the G8 demonstrates its inexperience as a global leader. The German G8 agenda, since the first tentative G8 agenda was submitted to the Cabinet in October 2006, has been a flexible document without clear priorities and a strategy for leveraging results. Targeted issues have been picked across all political areas and new issues have invariably been added.[1]

Such inflation is an all too common phenomenon and, in the case of the German G8 Presidency, it has been given an extra flavour as the G8 priorities have often been discussed in the same breath as priorities for the German EU Presidency. In many instances it has been difficult for initiated observers to understand if drafted ideas should be regarded in a G8 or a EU context. For sure there are overlapping issues, but the German government has also made a point of not mixing the two agendas. One can understand such a strategy: broad multi-tasked and multi-focused agendas run the risk of blurring core strategy. But it is understandable only to a point. The separation is also a product of the excessive compartmentalization of German bureaucracy. By not connecting yin and yang in this year of Presidencies, Germany has neglected an opportunity of building an entrenched agenda, enforced by an EU endorsement, in which one element could underpin the other and vice versa.

Equally important, the issues elevated to the G8 agenda have neglected the subtle mechanics of international policy coordination. Very few of the items on the German G8 agenda meet the standard test for successful policy making on an international scene. This is particularly true for the sets of issues that Chancellor Merkel has underlined as the core part of the agenda: innovation and investment, reducing global imbalances, improved transatlantic relations, and Partnership Agreements between African countries and G8 members.

Innovation and investments are primarily about freedom to invest and enforcement of intellectual property rights. These are both areas of concern, but the concerns do not derive from the conduct of G8 members, which are all developed nations. They are

[1] See Fredrik Erixon and Andreas Freytag (2007), Germany and the G8 Presidency, ECIPE Policy Briefs 02/2007, Brussels

rather developing-country concerns – issues where essentially all reforms would be assigned to non-members of the G8. Such an ambition needs another setting.

Reducing global imbalances rests on the long tradition of G8 intervention in current account and monetary affairs. But what can be a relevant G8 agenda when there is a clear difference in opinion over the cause and magnitude of this problem between G8 members? And what tools do G8 members command to correct the imbalances without seriously distorting the world economy?

Crippled world trading order

The third area – improved transatlantic relations – is different. It is not a G8 issue, but Chancellor Merkel has used the G8 Presidency to promote the idea of deeper economic integration across the Atlantic, the core strategy for improving transatlantic relations, in Washington, Brussels, and European capitals. Merkel's efforts have yielded results. Her initiative for regulatory harmonization has been endorsed by both European and American political leadership. It was a featured topic of the agenda for the EU-U.S. summit in late April. Both parties are currently reviewing the actual implications of deeper integration and considering an agenda for negotiations.

This initiative should be viewed in the context of a crippled system for WTO negotiations and German foreign economic strategies. The Doha Round has been in a crisis mode almost since it was launched. It is a product of the special sentiment in favour of international cooperation that emerged after the 9/11 atrocities. To the cynical observer, the Doha Round would never have been started had it not been for this tragedy. But the post-9/11 glue could not hold the Doha Round together infinitely. Apart from the considerable slowdown of external liberalisation in recent years, there are other structural problems in the world trading order that makes ambitious multilateral results less likely.

Firstly, decision making in the WTO has been weakened by the sizeable expansion of membership in the last two decades. The multilateral trading order that emerged after the Second World War was distinctly western in nature and pillared on Europe and the United States. GATT, the predecessor to the WTO, was a small club-like organisation for countries similar in level of development and production structure. In this milieu, the mechanism of reciprocity worked fairly well: countries exchanged "concessions" (market access) with each other. The Dillon Round in the early 1960s, and especially the Kennedy Round later the same decade, resulted in substantial tariff reductions and the negotiations run for just a few years.

The expansion of membership is not only about numbers. Equally important is the diversion of interest that growing membership entailed. The WTO is an organization for progressive reductions of barriers to trade, but that is an ambition that several members cannot comfortably endorse. The WTO is a marketplace for bargains – for a reciprocal exchange of concessions – but a sizeable part of the membership rather views it as a marketplace for transfers – a one-way distribution of trade benefits or of aid. In such a milieu, multilateral trade liberalization is predestined to be highly complicated, if not impossible.

Secondly, the transformation of the GATT into the WTO has been troublesome from a sectoral point of view. The GATT was an organisation for reductions of tariffs and non-tariff barriers in the industrial and goods sector. The WTO is a much wider organisation that incorporates the agriculture and services sectors as well as regulatory structures. This extension mirrors the general economic development, especially the growing importance of services for national income.

The Doha Round rests on the idea of a grand bargain between member countries. Put shortly, developing countries should get better access to rich-country markets for agricultural and semi-industrial produce; developed countries should get better access to other rich-country markets and to developing-country markets for services and high-tech goods. This strategy looks good on paper, but in reality it has been difficult to facilitate this multi-sectoral exchange. What differ from the GATT era of inter-sectoral exchange are primarily sluggish factor transfers between sectors within countries. In the GATT days manufacturing labour unemployed due to increased trade could find new jobs within the same sector. This was a transfer *within* the same sector and it did not require any re-education beyond on-the-job training. The multi-sectoral transfer envisaged in the grand-bargain structure of trade will require a movement of labour *between* sectors. An unemployed farmer should find a new job in an advanced industrial or services sector.

This is a stylized version of adjustments to trade. In reality the trade-labour transfer has never been as clean and straightforward as textbook theory puts it. But trade policy is neither a direct translation of trade theory, nor a function of empirics and experience. Trade policy is rather exercised in an increasingly politicized milieu in which the effect of trade on labour has been adversely exploited and aggravated the technical complications of moving from an inter-sectoral structure to a multi sectoral. The politics of trade has become highly infectious and commands a growing negative influence on trade policy.

Transatlantic relations

The German government has neglected to use its double Presidencies to advance the Doha Round. This was a mistake. Germany has a key role in EU trade policy and is one of the countries that need to move its position substantially, especially on agricultural trade, before any real advancement can be achieved. But the mistake was deliberately made, partly also for understandable reasons: the dire straits of the negotiations cannot be remedied only by German intervention.

Chancellor Merkel's core trade strategy has rather been to reinvigorate the idea of deeper economic integration across the Atlantic. This is indicative for German foreign economic policy: the post-Cold War regionalism is followed by a new regional context rather than a multilateral strategy. There are other elements in this policy as well; the belief in a rejuvenated transatlantic axis as the basis for multilateral leadership is prominent among them. But the Merkel initiative and the unfavourable attitude towards multilateralism is primarily a corollary of past regional strategies, not an unbiased assessment of what course of policy that would yield most benefits to the German economy.

Transatlantic regulatory harmonization is an appealing idea. Yet it is naïve to believe that such negotiations would progress easily. Past efforts to deepen transatlantic economic integration have ended in failures. Since the 1995 EU-U.S. summit in Madrid a transatlantic marketplace has been on the agenda, but every effort of serious negotiations has encountered the problems of two different cultures of regulation and regulatory harmonization.

Transatlantic talks have also suffered from the lack of an ambitious context. Limited ambitions, a small context, may be more feasible from a technical point of view than a larger context of a common market. Yet from the vantage point of politics limited agendas can be more difficult to progress as they yield smaller overall benefits. However cautious the applied approach is, the limited agenda will also entail losses of jobs or privileges for certain groups. Such losses are difficult to politically "sell" as they are not balanced by a much greater overall outcome for the whole country.

A common marketplace is an alternative to a limited approach. Chancellor Merkel clearly wants to move in this direction, but technically it is a more cumbersome alternative. It would involve not only an extended agenda of regulatory harmonization in sensitive areas (environmental regulations, precautionary principles, antitrust policies, et cetera), but also agricultural liberalization to an extent that neither American nor European farmers would endorse. There would also be multilateral concerns associated with such an agenda. A preferential agreement between the two biggest trading blocs in the world would clearly affect the relevance of the WTO. An open invitation for others to join such a common marketplace, or multilateralizing it by applying the Multi-Favoured Nation principle, would lower the risk of trade diversion and an "Atlantic fortress". But others would have to join on the conditions set by the EU and the U.S., and apply the same standards as agreed by them.

This is not a rejection of a transatlantic marketplace. A common market would undoubtedly lead to considerable economic and political benefits.[2] But ambitions must be realistic and conducive to the political economy of trade liberalization and regulatory harmonization. There must be a viable strategy for the negotiations as well as for how to cushion the effects on the WTO and third countries. These ingredients are yet missing in the Merkel initiative. If the German government is serious about advancing this initiative as a first step towards a common marketplace, now is the time to develop a cogent strategy and the metrics of its foreign economic policy.

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[2] See also Donger, Juergen B., Andreas Freytag and Ralf Zimmermann (1997), TAFTA: Assuring its Compatibility with Global Free Trade', *The World Economy*, 1997 Supplement: Global Trade Policy, 20. Jahrgang, August 1997, S. 567-580.