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THE RISE OF EUROPEAN PROTECTIONISM

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Abstract: This article analyses the rise of the European Union protectionism in the field of international trade, foreign investment, and global production chains. The scope, forms and dynamics of restrictive measures in each of these three segments of modern global economic connectivity are investigated. Although far from the concept of the free market, some protective measures have an explanation in emergency situations such as the World Financial Crisis and the disturbances due to the Covid-19 pandemic. In contrast, protectionism in the field of foreign direct investment, shaped by the newly introduced screening mechanism in the European Union, has a clear discriminatory character. It is similar to several packages of politically motivated restrictive trade measures. The documents of the European Commission, which prescribe the stated protectionist measures, lead to the conclusion that the EU is implementing a bloc division, that is, to protect its economies from the global environment, rather than to integrate into it.

Keywords: protectionism, European Union, trade, FDI, screening, value chains.

INTRODUCTION

After decades of intensive efforts to dissolve barriers and borders, both in their own and foreign markets, there was a sudden rise in protectionism in Europe, particularly in the European Union (EU). This implies restrictive

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measures with harmful effects on international trade and foreign direct investments (FDIs), both inward and outward. Besides direct protectionism, withdrawing trends in European production (or value) chains also indicate a significant degree of protectionism. Despite its importance for ensuring Europe's strategic autonomy and the EU's industrial future, value chains in the European Union are beginning to lose their importance. The weakening of international economic connectivity and the rise of protectionism requite unexpected phenomena after the strong, decades-long momentum of economic globalization. In all these cases, major changes have taken place since the Global Financial Crisis (GFC).

The general hypothesis of this research is that after the Global Financial Crisis, the European Union adopted a block approach to the economy in terms of rebuilding the barrier to the external environment. Indicators used for formulating this hypothesis are a) the growing number of EU trade restrictions, b) the lengthy public debate on the introduction of screening for FDI and c) numerous examples of withdrawal of European companies from non-EU countries.

The aim of this research is to determine the intensity of growing European protectionism, by analysing the restrictive trends in key segments of international economic connectivity: trade, global value chains, and FDI.

The first chapter is a review of recent literature related to current changes in all three analysed areas of international economics, especially the literature that includes these changes in Europe or the European Union.

In the second chapter, the degree and directions of European trade protectionism will be analysed, using data on the number of newly introduced restrictive measures in European countries. Protective trade measures include contingent trade-protective measures, export-related measures, tariff measures, trade-related investment measures, but also subsidies, according to the set of measures used by the Global Trade Alert (GTA).

The third chapter examines whether and to what extent there has been a shortening of European GVCs. Global production chains (GVCs) are groups of interconnected but geographically dispersed production units, which are measured by the share of foreign value added (FVA) in exports. This trend will be analysed at the level of the whole of Europe, but also of individual larger economies.

The fourth chapter examines the EU's restrictive measures in the field of FDI, with special reference to the new screening instrument, which includes special procedures for FDI originating from Asian countries in sectors that have been declared protected.

LITERATURE REVIEW

The current trend of mass trade protectionism is a relatively new phenomenon which developed during and after the GFC from 2008. Having in mind the previous decades-long trend of trade liberalization, the return of protectionism is strongly seen as a negative phenomenon and even a step backward in economic globalization (Erixon and Sally, 2010; Steinbock, 2018). Jacoby (2018) and Evenett (2019) consider this phenomenon a symptom of serious disturbances in the international economic system and the beginning of deglobalization. Evenett's contribution to the study of this phenomenon is much more significant than his articles published on the subject. This refers to its launch of the online database Global Trade Alert (GTA, https://www.globaltradealert.org) established in June 2009 with a purpose to record any restrictive measure of each country, which positively or negatively affects international trade. The GTA initiative was established due to previous sharp global economic downturns that have brought "extensive discrimination against foreign commercial interests" (Evenett, 2019). This database also includes all subsidies, FDI restrictions, and migration. The GTA database is useful both for international business, as a source of information about the policy environment they face, as well as for scientific research of the world economy. Some of the most recent researches explore the effects of the US-China trade war. Fajgelbaum et al. (2020) have made a significant contribution by statistical analysis of the negative effects of protectionism on the American economy, as well as Huang et al. (2018) and Crowleyet al. (2018) investigated the negative effects on China's economy.

The important theoretical framework and advantages of GVCs were given by Gereffi (2018). The authors Cattaneo, O., Gereffi, G. and Staritz, C. (eds.) (2010) analysed the state of GVCs after the Global Financial Crisis (GFC) but generally did not recognize its fragility and future inability to recover. UNIDO reports (2016; 2018) stressed the usefulness of the value chain approach for understanding development and especially industrial development, its sustainability and inclusiveness. Kummritz et al. (2016) have found that strengthening a country's GVC participation may lead not just to higher value added, but also in output, productivity and jobs. The research of Kordalska and Olczyk (2019) is significant for the second part of this study, dedicated to international production. Their research analysed the role of the hub of Germany in the trade of the selected CEE countries and showed the deep integration of CEE into German production chains. For this subject are also important Baldwin and Lopez-Gonzalez (2015) and Meng (2019), which also found that GVCs do not occur in a linear form by production stages, but that there is always one dominant economy at the centre of the chain.

Declining in FVA in Europe is a slow process so that there is very little literature on that. The newest is the research of Solleder and Velasquez (2020) which suggests that the EU imports of manufacturing inputs will drop more significantly after 2020. It is similar to scientific articles on the negative trends of FDI in Europe. Two papers on this topic stand out. Those are: Reins (2019) and Zwartkruis and de Jong (2020). Both papers refer to a new restrictive measure in the European Union - FDI screening. Reins (2019) views this measure from the angle necessary for the EU to establish energy stability and control of energy resources. Zwartkruis and de Jong (2020) analyse legal and practical challenges of screening of FDI. They see it as a legally controversial and practically not very useful instrument of restriction of free capital movement.

Another, newer form of European Union protectionism is keeping a distance from European non-EU countries. In terms of content, this belongs to the field of high politics and therefore is not the subject of this research, but it is important for insight into the whole and dimensions of EU protectionism. This topic was very thoroughly addressed by Petrović (2019) through the analysis of procedures and problems faced by Serbia and other countries of the Western Balkans in the process of endless accession to the European Union.

One of the main goals of this study is to fill the existing gap in the literature by analysing the reducing the degree of economic openness of Europe in all three aspects: international trade, production and investment.

THE RISE OF TRADE PROTECTIONISM IN THE EUROPEAN UNION

The Global Financial Crisis (GFC) has left more lasting effects on world trade than on individual economies. The volume of trade is declining in some regions, stagnant in others, but what is particularly important is that this process continues even after more than a decade since the end of the Crisis. In February 2017, Germany, Italy and France addressed the European

Commission with a proposal to improve the level of trade and investment in strategically important areas that have been the focus of foreign investors in state ownership or under state control. Given that many countries continue to establish inappropriate barriers and do not provide a level playing field for EU FDI, it was concluded that the EU must adopt appropriate measures to remain open to other countries while ensuring more effective protection of key economic areas from foreign investment, which could harm its security and public order (Dimitrijević, 2018, p. 161). In the European Union, international trade was still growing at a moderate pace until 2018. In 2019, the value of trade was almost the same as in 2018, and in 2020, it was reduced due to the general economic stagnation caused by the Covid-19 pandemic. By 2019, in Europe, unlike global parameters, the parameters of foreign trade have not changed significantly. What is a new and unexpected phenomenon in Europe is the rapid growth of trade protectionism generally atypical for this region, especially for the European Union.

The weakening of economic activity during the GFC initiated a number of restrictive trade measures of both developed and developing economies. The degree and directions of European trade protectionism is a subject of special interest. Protectionist measures, which negatively affect international trade, include: subsidies (excluding export subsidies), contingent trade-protective measures, export-related measures (including export subsidies), tariff measures, trade-related investment measures. This set of measures is used by the Global Trade Alert (GTA), which includes more forms of restrictions than the World Trade Organization (WTO).

Several key trade routes have been suspended by a series of restrictive measures as early as 2012-2014. These are Russia's trade restrictions on the EU, North America and Latin America, then the sanctions imposed by the EU on Russia in response to the annexation of Crimea. All of these restrictions are still in place. The culmination of this trend was a trade war between the US and China, which marked the international trade in 2018 and 2019. The Trump administration tried to influence the economic and geopolitical growth of China, using the "tactics of great pressure" (Jović-Lazić, 2019, p. 156). In addition to introducing the various tariff measures, the United States also called on the allies not to buy Chinese technological products and sell advanced technology to China (Jović-Lazić, 2019, p. 156). This attracted a lot of public attention so that European protectionism remained in the background.

What also goes unnoticed is that American protectionism is limited to Donald Trump's policy toward China, which is exposed to over 1,200 US trade-restrictive measures (GTA, 2020). These measures are not protectionism that affects a large number of countries. When Trump leaves the power at the end of 2020, this approach will almost certainly soften. In contrast, the protectionism of the European Union is a more permanent commitment, i.e., the EU's trade and investment protectionism have become a strategy towards the rest of the world. These measures have been considered and adopted by most EU countries and recorded as strategies in the documents of the European competent institutions.

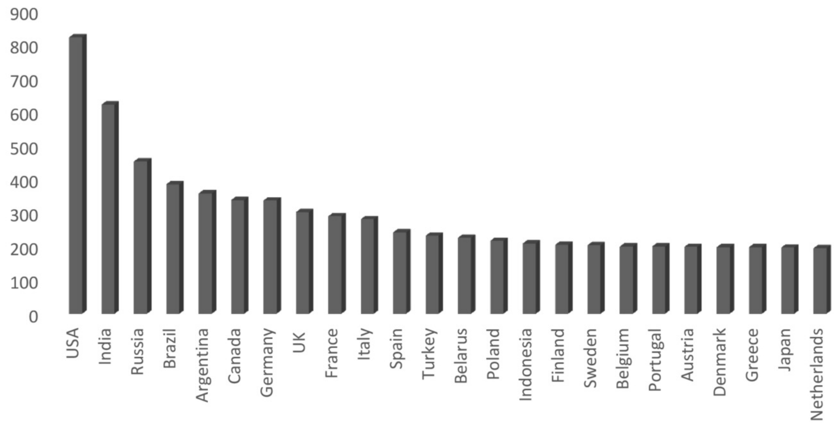
Thus, the protectionism of the European Union began much earlier than the US-China trade war. EU trade-restrictive measures escalated in the trade conflict with Russiain 2014, but a number of measures were adopted during the 2009 GFC.

The European Union is working intensively and relatively successfully on removing trade barriers of its partners, in order to support the exports of its companies. On the other hand, the number of restrictive measures against partners is continuously increasing. "All of these trade initiatives are part of a wider effort by the European Union to ensure we build the foundations for resilience, competitiveness and growth; developing mutually beneficial bilateral relations, while taking the internal measures needed to strengthen our economy, and defend it from unfair and abusive practices" (European Commission, 2019, p. 2).

The growth of trade protectionism was further contributed by the Covid-19 pandemic when trade protectionism escalated. All countries, despite a number of formal restrictions provided by the WTO and especially the European Union, during 2020, have also provided massive subsidies to large companies, airlines, banks, etc., to save them from bankruptcy. In addition, basic food products in the EU are additionally protected. For example, import duty on maize, sorghum and rye was subject to restriction twice in one month. The European Commission issued a Regulation on 27 April 2020 imposing the duty rate of EUR 5.27 per ton. On 5 May 2020, the same Commission issued regulation, increased an import duty to EUR 10.40 per ton.

The EU does not have many restrictions in the area of trade in services, but in terms of trade in goods, the EU countries occupy 13 of the top 25 positions on the list of countries by the number of restrictive measures. In the period from 2009 to December 2020 (GTA, 2020), the individual leaders are the USA, India, Russia, Brazil, and Canada. Only then do the EU members follow. However, the EU trade-restrictive measures are mostly part of the EU-wide restrictive packages, and rarely the regulations of individual countries. Viewed in this way, these 13 countries have collectively imposed around 3,000 protective measures on non-EU countries (GTA, 2020).

FIGURE 1. COUNTRIES WITH THE HIGHEST NUMBER OF RESTRICTIVE MEASURES IN TRADE IN GOODS



Source: Author according to GTA, 2020.

The largest EU countries are in the lead: Germany with 337 protective measures, Italy with 405, France and Spain with more than 300 (figure 1).

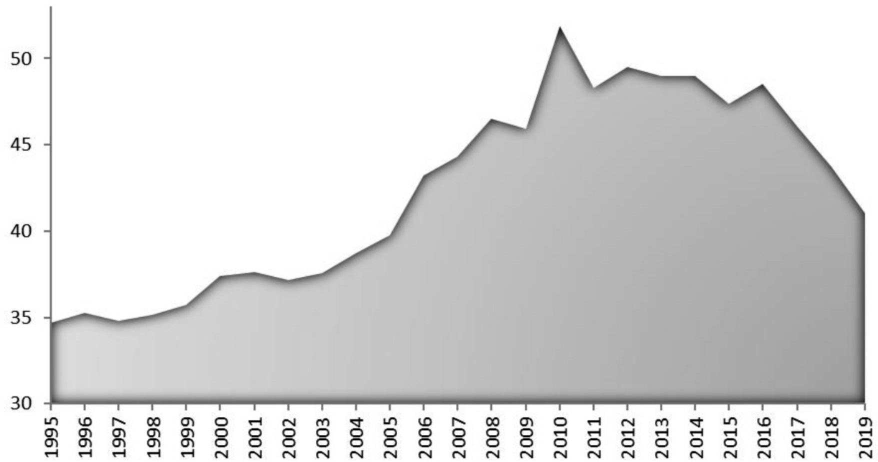
SHORTENING OF EUROPEAN VALUE CHAINS

International segmentation of production processes is the most specific and the newest form of modern globalization. "The driver of international production segmentation was to achieve the most cost-effective structure for each stage of the production process" (Gereffi, 2018). Almost all exporting companies, with or without the participation of foreign capital, are part of global value chains (GVC). They are international (rather regional than global) production networks of geographically dispersed production units in different countries. GVCs are a specific mark of the modern world economy. One-third of the total international trade takes place within GVCs.

The main indicator of economic integration in international production is the foreign value added (FVA). This is the value of an imported semi-finished product that is ready for further processing and export. So, it is a part of the trade, but a part that implies much wider change in the European economy than the decline of the trade. In only one decade, the share of value chains in European exports has fallen from 52% to 41% (figure 2).

As figure 2 shows, FVA within European supply chains had a sharp rise until 2010. Then, as a result of the uncertainty and instability of the market caused by the GFC, European multi-national companies begin to withdraw production segments to their home countries or enter into mutual mergers, losing the need for a large number of suppliers. GVCs is getting shorter that way.

FIGURE 2. SHARE OF FOREIGN VALUE ADDED IN EU EXPORT



Source: Author according UNCTAD (2020) Eora Database

The host countries of the largest multinational companies, the US and the UK, are also facing a steady decline in FVA, as does Germany, whose international production mainly takes place in the European Union's neighbourhood. In the years after the GFC, FVA share in US exports decreased from 12 to 9.5%, in the UK from 33% to 26%, in Germany from 52% to 43%, in France from 38% to 33% (author's calculation based on UNCTAD, 2020, Eora database) (figure 3).

FIGURE 3. INTEGRATION OF MAJOR INVESTOR COUNTRIES IN GLOBAL PRODUCT CHAINS, REFLECTED BY THE FVA SHARE IN EXPORTS, (%)

Source: Author according to UNCTAD-stat, unctadstat.unctad.org, and the World Bank, data.worldbank.org/indicator.

The direction of change in the EU refers not only to the disruption of existing GVCs but also to the announced direction of future ones. The future focus of European supply chains was defined by the European Commission in 2019. The Commission has identified only six strategic value chains into which the EU will direct resources. They all rely on the concept of sustainable development. These are: Clean and autonomous vehicles, Hydrogen technologies and systems, Smart health, the Industrial Internet of Things, the Low-CO2 emission industry and Cybersecurity (Strategic Forum, 2019). The very choice of sectors for key EU supply chains indicates the intention to intensify exchanges between the leading EU countries and reduce the connection with less developed countries and those outside the EU. Such a strategy obviously imposes a further shortening of European supply chains.

Lockdowns caused by the Covid-19 pandemic further contributed to the disruption of value chains and accelerated the process of their shortening. GVCs are impacted directly through supply chain linkages when companies in any country stop producing. In addition, the Covid-19 also affected value chains by causing disruption in international transport. Even when the production itself was not compromised, the inability to supply export partners in many cases led to production interruptions. The pandemic had the strongest and most lasting effect on GVCs by reducing demand.

Through value chains, the epidemic has even affected countries where production has not been interrupted, and whose production is not directly dependent on vulnerable economies. Producers at the beginning of the production chain (raw materials and services) are prevented from exporting goods due to demand disruptions in the next downstream market. Manufacturers of parts, components and semifinished goods reduce their output due to the suspension or reduction of imports of the downstream market of finished goods. Therefore, they also reduce inputs from abroad. Breaking up value chains in some sectors resulted in pressure to *re-nationalize* production in the belief that this would provide greater security of supply.

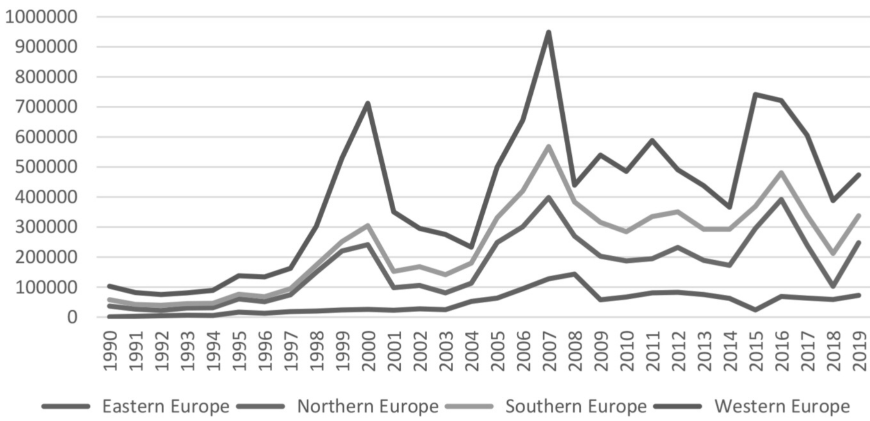
FOREIGN DIRECT INVESTMENTS TREND IN EUROPE

The traditional EU approach to FDI is based on a positive view of the free movement of capital. The EU was one of the world's most open destination for foreign direct investment in the world. But things are also changing in this segment of the international economy. As executive Vice-President Dombrovskis said: "The EU is and will remain open to foreign investment. But this openness is not unconditional" (European Commission, 2020a).

Particularly frequent is the introduction of *screening,* mandatory assessment of the inflow of foreign investment by an authorized agency. In March 2019, the EU has adopted a Regulation on the screening of foreign direct investment (FDI). "Member States are allowed to use a national screening mechanism for FDI from outside the EU on the grounds of widely defined public order or security, including the protection of key technologies" (Zwartkruis, de Jong, 2020). This mechanism started to apply on 11 October 2020. It was introduced by 24 countries, which together account for more than half of the world's cumulative FDI (Stanojević, 2020, 350). Also, more than 40 amendments to the list of sectors or economic activities, subject to screening, were adopted in 2018 and 2019.

However, European FDIs, inward and outward, collapsed in 2008, long before the introduction of screening, and have never reached pre-GFC values since then (figure 4 and figure 5). The inflow of FDI into Europe is halved, in the period 2016-2018 (figure 4), and some countries registering a negative inflow as a result of the withdrawal of investment funds by US multinational companies (MNC).

FIGURE 4. FDI INWARD IN EUROPE 1990-2019 (1000 USD)



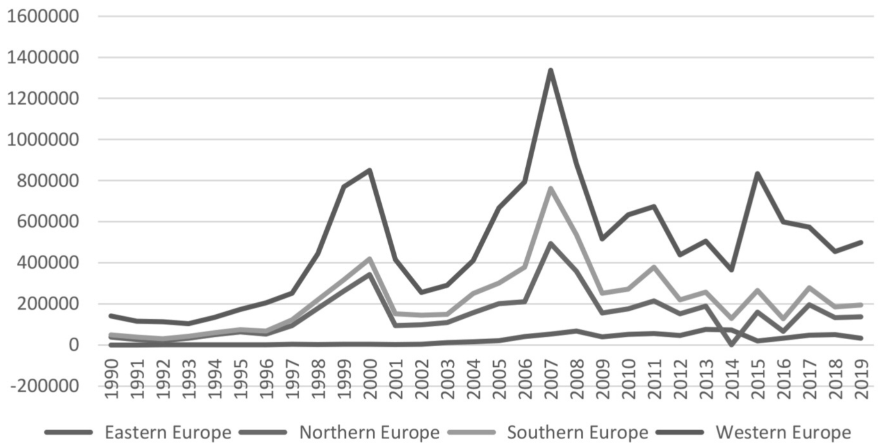
Source: UNCTAD stat (2020)

Due to screening, the FDI inward will certainly be further reduced in the coming period, but the reduction should not be so significant. Namely, the mechanism of screening is the result of EU concern about the loss of strategic technological knowledge and technological advantage over emerging economies. There is also a concern in the EU that China is competing in an unequal way, that is, Chinese and EU companies do not compete directly, but Chinese companies have a great advantage due to the support and protection provided by the Chinese state. More precisely, the initial problem was China`s policy instruments for the implementation program *Made in China 2025,* which have included *technology seeking investments abroad*. Many of the FDI from China into the EU are "aimed at EU companies that have technological knowledge that China can use to upgrade its industry" (Zwartkruis, de Jong, 2020, p. 6). Accordingly, areas subject to screening have been identified as: defence and security, energy, businesses supplying critical technologies, infrastructure, inputs or access sensitive information (European Commission, 2020b). "The EU wants to maintain an open investment environment", but, "the reflection paper on *Harnessing Globalization* recognized increasing concerns about strategic acquisitions of European companies with key technologies by foreign investors, especially state-owned enterprises" (European Commission, 2017). The last term - "state-owned enterprises" clearly indicates that the entire screening instrument was launched as prevention of Chinese leadership in the field of high technologies.

After several years of negotiations about Chinese investments in the EU, in the last days of 2020, two sides reach an agreement in principle, called the *Comprehensive Agreement on Investment* (CAI). A key point of the agreement is the rules against forced technology transfer. The CAI includes obligations for the conduct of state-owned enterprises, comprehensive transparency rules for subsidies, and obligations related to sustainable development. Even if all the provisions of this agreement are successfully implemented in practice, that does not diminish the fact that the EU is "defending" itself from the inflow of foreign capital.

Inward and outward European investments have been dramatically reduced since the Crisis. Several early abrupt reductions in FDI were the result of the recession of the European Union and US economies in 2001 and 2007-2009. The current decline in foreign investment is not the result of the Crisis. Economic growth has slowed globally, but it still represents growth, and no major economy is in recession. Trust in investment security, as an important condition for FDI, is severely disrupted by restrictive policies of large economies. The number and scope of restrictive measures in the area of foreign investment have had a pronounced upward trend since the GFC. Restrictive measures include a number of instruments, which have negative effects on FDI in different ways. The most direct measures concern the restriction or prohibition of the inflow of foreign investment in certain economic sectors, but there are also restrictions on outward investment in certain foreign countries or sectors. The states that are home to the largest MNCs, intensifying their efforts to reduce and discourage capital outflows from the country. Such measures were adopted by the Committee on Foreign Investment of the USA, the European Commission, Germany, the United Kingdom, Italy, as well as China. These are, to a large extent, the causes of the decline of outward FDI from Europe (figure 5).

FIGURE 5. FDI OUTWARD FROM EUROPE 1990-2019 (1000 USD)



Source: UNCTAD stat (2020)

The general instability of market conditions and reduced demand play an important role in the sharp decline in European FDI inflow and outflow. So, screening and other forms of protectionism were not the only cause of this trend, but "more important is the contribution of protectionism to the creation of negative investment environment" (Stanojević, 2020, p.350).

CONCLUSIONS

Multiplication of barriers to foreign trade and foreign direct investment, as well as reshoring of supply chains, have led to the world economy becoming less and less integrated. The European Union, although based on the concept of economic freedoms, generally does not lag behind the newly formed American protectionism, and in some segments, such as FDIs, the EU is even in the lead.

In terms of trade restrictions, individual EU countries have fewer newly introduced protective measures than the USA. On the other hand, if we look at the EU as a single market, trade protectionism far exceeds that of the United States. A large number of protective trade measures have strained political relations with Russia in the background. Restrictive measures against other countries have no political background but are motivated by the need of the EU to protect their economies from the dramatically changed state of the world economy. This primarily refers to the reduction of demand and economic activities due to the Global Financial Crisis. Many tariffs have been increased and exports limited during the state of emergency in the global economy due to the Covid-19 pandemic.

The GFC has also changed market conditions and caused general uncertainty about the profitability of investments abroad. EU companies reacted by withdrawing key production processes from the global market. European MNCs are retreating into national contexts partly because of the volatility of the global market, caused by the GFC, and partly due to the changed conditions, which no longer provide extreme profits. With international input prices converging, too long GVC no longer justifies the high transportation costs.

Protectionism in the field of FDI, although not large in a number of measures, is huge in the scope of measures that prescribe screening. Secondly, in the legal sense, the screening has caused numerous controversies and disagreements, because it is a matter of direct discrimination of investments from China and India. The measures were adopted based on the assessment of the European Chamber of Commerce that China has a strategic interest in investing in European companies in the field of high technologies in the future. These protectionist measures undoubtedly have a discriminatory character.

Some trade protection measures during the Crisis or Pandemic, which restrict the export or import of strategic products, although very far from the free-market concept advocated by the EU, are the natural responses of responsible governments. The withdrawal of GVC, although it excludes non-EU countries, is not disputable because its subjects are companies that behave in accordance with market conditions. On the other hand, trade restrictions introduced on a political basis, as well as the described discriminatory FDI restrictions, clearly indicate the EU's block division approach, that is, the protection of EU economies from the environment rather than integrating into it.

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