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Fredrik Sjöholm

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Research Institute of Industrial Economics
P.O. Box 55665
SE-102 15 Stockholm, Sweden
info@ifn.se
www.ifn.se

Navigating the New Normal: The European Union's Changing Stance on Globalization in the Era of Trade Conflicts

Fredrik Sjöholm[1]

The Research Institute of Industrial Economics (IFN)

Stockholm, Sweden

fredrik.sjoholm@ifn.se

Abstract

The European Union (EU) is becoming more inward looking and more hesitant toward globalization. This paper examines recent transformations in the EU's economic policies, with a focus on international trade and industrial policy. It argues that these changes reflect the EU's response to the evolving global economic and political landscape, driven by factors such as China's rise and the U.S.'s protectionist policies. By analyzing the potential consequences of these policy adjustments on EU industries' competitiveness and trade relations, the paper offers insights into the future prospects of EU economic policies and their role in shaping the global economy.

JEL codes: F02; F15; F51

Keywords: Globalization; European Union; Trade War; Industrial Policy

1. Introduction

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The post-war success of the European Union (EU) can be attributed to globalization, which facilitated the dismantling of trade restrictions on goods and services within the union, and increased openness toward the global community. The EU has played a crucial role in promoting trade liberalization, and its member countries exhibit high trade dependencies. However, recent developments indicate a shift toward a more inward-oriented approach among European politicians and policymakers. This shift challenges the foundations of the internal market and raises discussions on the implementation of trade and investment restrictions with external partners. The driving force behind this change is the EU's recognition of new challenges in maintaining economic competitiveness, fostering sustainable growth, and safeguarding its industries from unfair competition.

This paper investigates recent transformations in EU economic policies, emphasizing international trade and industrial policy. We posit that these policy adjustments are the EU's reaction to the evolving global economic and political climate. Factors such as China's rise as an economic powerhouse with a distinct economic-political system, coupled with the U.S.'s protectionist policies, have directly influenced the European stance on open markets and global trade.

Over the past few years, EU-China bilateral relations have significantly deteriorated due to an increasing number of contentious issues. Despite their mutual dependence, the bilateral relationship has become increasingly strained as European governments have adopted firmer stances on various disputes, including human rights allegations, and unequal market access. The relationship with the United States has improved, in part due to the war in Ukraine, but

areas of disagreements remain and the recent introduction of large subsidies to American firms is a matter of concern to European policymakers.

This paper first examines the influence of the U.S.-China trade war on EU trade policies, highlighting the EU's pivot toward a more protectionist and cautious stance on globalization. Subsequently, the paper delves into the recent alterations in EU industrial policy and the growing involvement of the state in shaping the economy. We assess the potential impact of these policy shifts on EU industries' competitiveness and the possibility of trade conflicts with the United States and other nations.

Ultimately, this paper aims to offer an analysis of the recent changes in EU economic policies and their repercussions for the EU's position in the global economy. We contend that these policy adjustments signify the EU's attempts to tackle the challenges of the current global economic and political environment, while simultaneously promoting sustainable growth and shielding its industries from unfair competition. The paper concludes with reflections on the future prospects of EU economic policies and their influence on the global economy.

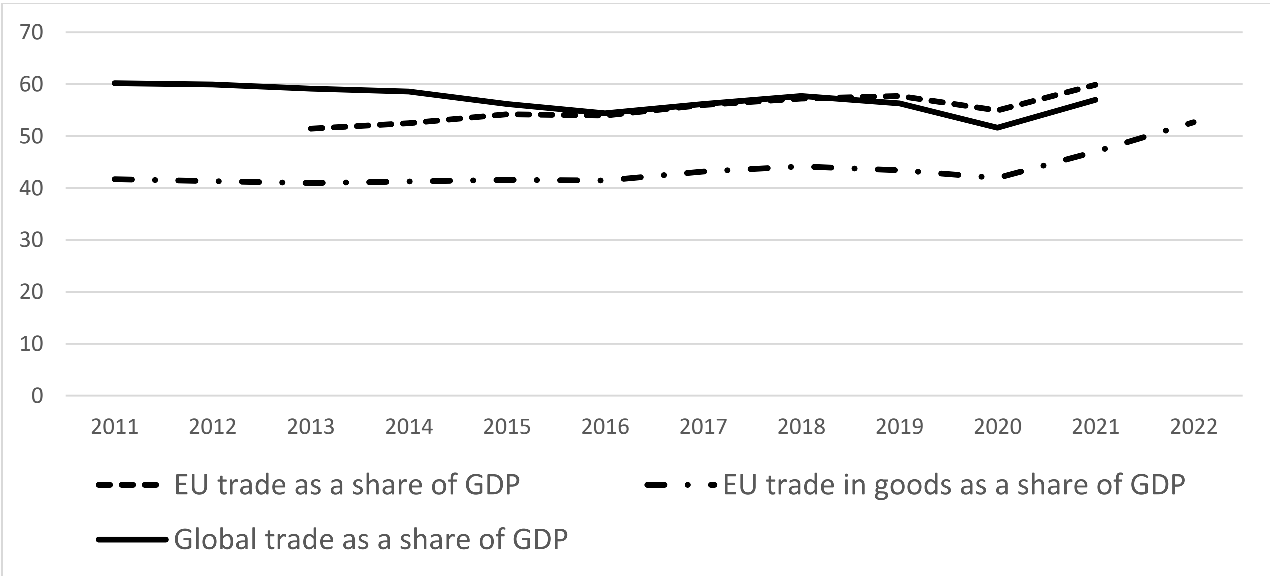
2. EU and globalization

Historically, Europe has been a strong advocate for trade liberalization, both within the region—through the creation of the internal market—and on a global scale, by supporting the World Trade Organization (WTO) and forming bilateral trade agreements. This has led to a relatively high trade orientation among European firms and countries, as well as a stable trade ratio that has not declined in recent years, as demonstrated in Figure 1. The figures for the EU show external trade, which includes trade between member and non-member countries.

External trade in goods rose from approximately 40 percent of GDP in 2011 to over 50 percent in 2022. When accounting for service trade, the figures show an increase from around 50 percent in 2013 to 60 percent in 2021. Consequently, external trade has grown in importance over the past decade. This contrasts with global trends, as Figure 1 illustrates: worldwide trade as a share of GDP has experienced a slight decline, falling from around 60 percent to approximately 57 percent.[2]

Hence, one cannot see any decline in the EU:s attitude toward globalization in trade figures, but one can see it in new economic policies, which in turn reflects a change in attitude. Although Europe has historically maintained a positive attitude toward globalization, this stance has shifted in recent years. The change began gradually after the financial crisis, and has accelerated in the last few years. While this shift does not represent a complete turnaround from the previous pro-globalization outlook, it is evident that the EU's perspective has become more nuanced (Youngs and Ülgen 2023), as reflected in many of its current policies.

Figure 1. Trade as a share of GDP in the EU and globally (2011-22; %)



[2] Global trade as a share of GDP peaked in 2007 at 61 percent.

Source: *Eurostat and World Bank. https://ec.europa.eu/eurostat; https://data.worldbank.org*

Note: *Trade is measured as external trade, i.e. trade with countries outside of the EU.*

The reasons why the EU has become more inward-looking appear to differ somewhat from those influencing similar developments in other parts of the world. For example, in the United States, a significant driver of change has been the distributional impact of globalization, with Americans experiencing income decline due to trade voting for political change (Autor et al. 2020). This aspect is presumably less relevant in the EU, given that inequality has not shifted as much there as it has in the United States and many other countries. The EU's Gini coefficient for disposable income (including social transfers) has remained stable at around 0.3 for an extended period.[3] Hence, it is necessary to consider factors beyond distributional aspects to comprehend the changes in the EU's economic policies. One such factor is the influence of developments in other parts of the world, particularly in the United States and China.

3. The internal market faces challenges

The United Kingdom's decision to leave the EU, known as Brexit, in 2016 dealt a significant blow to the internal market. After years of negotiations, the UK officially left the EU in early 2020. Brexit stemmed from growing discontent with globalization and perceived excessive centralization in the EU. Colantone and Stanig (2018) show that China's integration into the global economy affected the way British people voted in the referendum. Specifically, districts with industries adversely impacted by increased imports from China voted for Brexit, while those unaffected by China voted against it. The "China effect" proved more influential

[3] Data on income distribution in the EU can be found at Eurostat. https://ec.europa.eu/eurostat

than the effect of immigration, an aspect frequently proposed in media discussions as the primary driver of Brexit. It may seem counterintuitive for voters to support Brexit due to trade with China, which is not directly affected by the EU. One possible explanation suggested by Colantone and Stanig is that both the EU and China were viewed by voters as part of a broader globalization process that shifted power and decision-making out of their country, a development many found objectionable.

Brexit naturally had a considerable impact on the remaining EU countries. On one hand, support for the EU increased, possibly in response to the economic and political difficulties that the UK faced following Brexit. In 2022, two-thirds of Europeans considered EU membership a "good thing," the highest figure in 15 years (European Union 2022).[4] On the other hand, the EU has continued to introduce policies that run counter to the principles of the internal market and pursue greater centralization, trends that led the UK to leave the union. One example is the EU's response to the large influx of refugees in 2015. The 26 signatory countries of the Schengen Area have pledged to maintain open borders with other member countries without checks or requirements. However, temporary border controls are permitted in response to serious domestic security threats. Several EU countries used this rationale to introduce border controls in 2015. Many of these border controls persist today, despite being deemed legally baseless by the top EU court (Schacht 2022).

Another example is the reaction to the COVID-19 pandemic. Countries sought to secure access to medical equipment and medicines through various means. While the EU did not officially ban vaccine exports, it pressured producers to prioritize sales to EU countries, effectively achieving the same result as a ban (Sheftalovich and Deutsch 2021). This policy

[4] The war in Ukraine has presumably also led to a more positive attitude toward the EU.

was not unique to the EU; many countries worldwide attempted to secure medical supplies in a similar fashion. However, what made the development especially noteworthy was the implementation of policies restricting trade between member countries. Nations like France and Germany halted the export of medical equipment to other EU members, and European multinational firms encountered difficulties shipping such goods between their own factories in different countries.

4. The U.S.-China trade war and the EU

The trade war between China and the United States has had significant economic and political implications for the European Union (EU) and has influenced its policies. Both China and the United States are seeking support from the EU to advance their respective agendas on international trade, among other issues. However, the EU has its own interests, aligning with China on some points and with the United States on others. China and the EU share a critical view of U.S.-imposed tariffs and other trade restrictions, not only because the EU faces higher U.S. tariffs on steel and aluminum, for example, but also because these actions deviate from the previous rule-based global trade order. The United States and the EU agree that China employs unfair state-orchestrated business practices (Islam 2022). It is clear that the EU has moved closer to the United States in recent years, partly due to the conflict in Ukraine and partly due to a shift in European perceptions of China and its foreign policies. However, differences remain, and it is unlikely that the United States and the EU will adopt a completely unified approach toward China (Islam 2022).

Another important factor influencing the EU's stance is that the United States is a more significant export market for the EU than China, as seen in Table 1. External exports—

exports to countries outside the EU—account for around 40 percent of total EU exports. The share of external exports to the United States is close to 20 percent, followed by 13 percent to the UK. Exports to China make up 9 percent of the total, just above the export share to Switzerland. Moreover, there are no signs that China will soon match the U.S. share; the differences in export shares were smaller in 2013 than in 2022. [5]

A similar picture is seen in the distribution of Foreign Direct Investments (FDI) in Table 2. The figures measure the stocks of FDI. The United States is the largest country for both inward and outward FDI accounting for close to one-third of the inward FDI stock and one-fourth of the outward stock. A relatively large share is also coming from tax havens, where the exact nationalities of the firms are unknown, from the UK and Switzerland.[6] The importance of the United States as markets for export and FDI for European firms likely plays a role in how the EU navigates between the interests of China and the United States.

Table 1. The share of EU's external export to the five largest export destinations (in percent).

	2013	2022
United States	13,8	19,8
United Kingdom	15,4	12,8
China	7,6	9,0
Switzerland	6,6	7,3
Türkiye	4,1	3,9

[5] China is an important trade partner in terms of import and accounts for almost 21 percent of EU's total import. Import has, however, not the same weight as export when it comes to political considerations.
[6] Most firms investing from tax havens are registered in Bermuda, Jersey, the Cayman Islands and the British Virgin Islands (Eurostat 2022).

Source: *Eurostat.*

https://ec.europa.eu/eurostat/databrowser/view/EXT_LT_MAINEU/default/table?lang=en&category=ext_go.ext_go_agg.ext_go_lti.ext_go_lti_ext

Note: *United Kingdom's export is excluded from the EU export figures.*

Table 2. The share of EU's inward and outward FDI by country (in percent)

	Inward FDI	Outward FDI
United States	31,7	24,3
Tax havens	27,3	15,2
United Kingdom	17	21,8
Switzerland	9,4	10,7
China	0,9	2,3

Source: *Eurostat (2022).*

Note: *China is included for comparison but is not the fifth largest country in terms of inward and outward FDI.*

At the onset of the U.S.-China trade war, some observers suggested that it would benefit EU exporters, who could gain market shares in both China and the United States. However, this does not seem to have happened, and most European firms view the trade war as negative for their businesses (Goulard 2020, 59). The adverse effects manifest in various ways. Firstly, the tariffs imposed by both the United States and China have disrupted global supply chains, leading to higher prices and reduced demand for goods and services (Huotari et al. 2021). This has negatively impacted the EU's export-oriented economies. Additionally, the trade war has contributed to a global economic slowdown, further dampening the EU's economic prospects.

In the long run, the primary risk of the trade war is the deterioration of the global rule-based trading system. The policies implemented by the United States and China, followed by the EU and other countries, have undermined the trading system. As a result, trade appears to be becoming more regional and less global (Legge and Lukaszuk 2021).

Politically, the trade war has occasionally strained relations between the United States and the EU, as well as between China and the EU. The EU has adopted a more cautious approach than the United States in responding to China's trade practices, fearing that a confrontational stance could backfire and harm EU businesses operating in China (Bomassi and Haenle 2022).

The United States has often criticized the EU's approach, arguing that it has not done enough to counter China's unfair trade practices. This has led to occasional tensions between the United States and the EU. One early example of critique was the U.S.'s opposition to the EU's decision to grant China "market economy status" in 2016. The EU's move to recognize China as a market economy would have made it more difficult for the EU to impose anti-dumping measures on Chinese imports, which are intended to protect EU industries from unfair competition. The U.S. view was that China did not meet the criteria for market economy status and that the EU's move could harm global efforts to address China's unfair trade practices. The United States also expressed concerns that the EU's decision would weaken the effectiveness of international trade rules and lead to a flood of cheap Chinese imports into the United States and other markets.

The election of Joe Biden as president improved the relationship between the United States and the EU. Tariffs on trade remain in place, but many steps have been taken toward deeper collaboration. The president has emphasized the shared values of democracy, human rights, and multilateralism that underpin the relationship between the United States and the EU (Islam 2022). For instance, the United States and EU have continued to cooperate on defense and security issues, including efforts to address evolving threats such as cyberattacks and disinformation campaigns. Moreover, the Biden administration has sought to address trade disputes with the EU, including suspending tariffs related to the long-standing Airbus-Boeing dispute and agreeing to work together on addressing global steel and aluminum overcapacity. The United States and the EU have also aimed to coordinate their approaches to China on various issues, such as trade, human rights, and technology. Both sides recognize the need to engage with China, but they also acknowledge the challenges posed by its economic, military, and technological rise.

Despite these positive developments, there remain some areas of disagreement and tension between the United States and the EU, such as digital taxation, data privacy, and Iran's nuclear program. Moreover, the U.S. practice to block the appointments of new judges in WTO's Appelate Body, which paralyses the dispute settlement, is criticized by the EU. Overall, however, the relationship between the United States and the EU has generally improved under Joe Biden's presidency, with both sides showing a willingness to work together on shared priorities and global challenges.

The EU's relationship with China is complicated and has deteriorated in the last decade, which is made clear in the failed investment agreement. China and the EU started negotiations on an ambitious investment agreement in 2014. The progress was slow because of increased

tensions caused by what was seen as unfair business practices by China. In 2020 imposed tariffs on Chinese goods, and China, in turn, imposed tariffs on EU goods. Moreover, the EU became more and more reluctant to allow foreign firms to invest if EU firms were not given equal treatment in the home countries of the same foreign firms. A similar view was seen on public procurement, where firms from countries, including China, who do not allow European firms to win public procurement contracts, faced increased difficulties in getting European contracts.

Despite all these difficulties, an agreement was ready to be approved in early 2021. The agreement between China and the EU addressed many of the issues of unfair business practices and would presumably have given European firms better access to the Chinese markets.

However, by 2021 the attitude toward China had deteriorated in most EU countries, partly as a result of China's new foreign policy and the infamous “wolf warrior diplomacy”. The crackdown on the democracy movement in Hong Kong, the increased threat to Taiwan, and the development in Xinjiang had a profound negative effect on the EU attitudes toward China (McElwee 2023). Criticism from the EU, in turn, led to strong reactions from China, sometimes imposing trade restrictions. As an example, in 2021 Taiwan was allowed to open up a de facto embassy in Lithuania. China responded by stopping Lithuanian rail freights along the new silk road and ceasing imports from Lithuania (Hackenbroich et al. 2022). China subsequently threatened other European countries with trade sanctions if they engaged in commerce with Lithuania.

Furthermore, in March 2021, the EU, along with the United States, UK, and Canada, imposed sanctions on Chinese officials due to human rights abuses in Xinjiang. China retaliated by sanctioning European lawmakers and researchers, leading to a decline in diplomatic relations between China and the EU. This escalation of events heightened mistrust between Brussels and Beijing, culminating in the EU Parliament's decision to suspend ratification of the agreement in May 2021.[7]

The conflict in Ukraine has further strained the relationship between the EU and China. This deterioration is partly due to increased awareness of the risks associated with engaging authoritarian countries, as previously discussed. A discussion has emerged on "decoupling": to move production home or to more friendly countries, a concept that sometimes goes under the vocabulary "friendshoring" (Goldberg and Reed 2023). Hence, a large part of trade conflicts is now caused by national security issues. China's implicit support for Russia's invasion, despite their usual emphasis on sovereignty and territorial integrity, has also contributed to the tensions (McElwee 2023).

The collapse of the investment agreement between the EU and China has not resulted in a status quo for Chinese investments in the EU; instead, such investments have become increasingly challenging to pursue. The EU has implemented a screening mechanism for foreign investments, including those from China, to safeguard its strategic assets and infrastructure from potential risks (Riela 2023). This framework is grounded in the EU's Regulation on the screening of foreign direct investments into the Union, which was adopted in 2019 and came into force in October of that year.

[7] There are in the spring of 2023 new voices that think that the agreement should be approved, this time as a way to make sure that China will not support Russia with weapons. https://www.politico.eu/newsletter/brussels-playbook/pulling-china-from-the-brink-cdu-backs-vdl-jailed-wsj-reporter/

Through the EU's screening mechanism, member states and the European Commission can scrutinize and potentially block foreign investments in critical infrastructure, sensitive technologies, and strategic assets across sectors like energy, transport, telecommunications, and healthcare. The objective of this mechanism is to ensure the protection of the EU's security, public order, and essential interests, including technological sovereignty.

The EU has expressed apprehension regarding China's state-driven economic model and its potential impact on EU security and economic interests (Poitiers and Domínguez-Jiménez 2020). As a result, the EU is particularly sensitive to Chinese investments in strategic areas, such as high-tech industries and critical infrastructure (Babić and Dixon 2022).

When a Chinese investment undergoes screening, the EU evaluates its potential effects on essential interests. This screening process may involve assessing the investor's reputation, the investment's nature and scope, and its potential impact on EU security and public order. Consequently, most EU members screen investments for security reasons, complicating the participation of firms like Huawei in European 5G networks and affecting FDI from China to the EU.

China has expressed concern about the EU's screening mechanism, arguing that it creates barriers for Chinese companies seeking to invest in Europe. China has also accused the EU of discrimination and protectionism, asserting that the screening mechanism unfairly targets Chinese investments and violates WTO rules. However, the EU's policies resemble those used in China, where FDI inflows have always been regulated with frequent requirements for local joint-venture partners and technology-sharing arrangements. The Chinese FDI regime is

governed by laws, regulations, and policies issued by various government agencies, with the primary regulators being the Ministry of Commerce (MOFCOM) and the National Development and Reform Commission (NDRC) (Zheng 2023).

In recent years, China has adjusted its own screening mechanism for foreign investments. To a large extent, the Chinese FDI regime focuses on national security concerns and aims to protect China's core technologies and strategic assets. Hence, it is similar to the EU policies, and a sign of how security concerns and intensified geopolitical tensions are shaping industrial and trade policies around the world. These considerations are also evident in China's recent "dual circulation" policies. China maintains a "negative list" for foreign investments, which outlines the sectors where foreign investment is either restricted or prohibited. The list has been updated regularly to gradually open up more sectors to foreign investment, with notable recent reductions in the number of restricted industries. Sectors not included on the negative list generally follow a more straightforward registration process (Zheng 2023).

There are also industries in China where FDI is actively encouraged, typically high-tech industries, advanced manufacturing, environmental protection, and energy efficiency. China has pursued bilateral investment treaties and other agreements with various countries to facilitate cross-border investment. These agreements often include provisions on reciprocal market access, granting investors from both countries similar access and protections when investing in each other's markets.

Concerns remain about the overall transparency and predictability of the Chinese's investment environment. Foreign investors may still face challenges, such as forced technology transfers,

intellectual property theft, and an uneven playing field in some sectors due to preferential treatment for domestic firms.

More specifically, China has introduced several measures aimed at increasing oversight of foreign investments, particularly in strategic sectors such as technology and finance. These measures include tighter restrictions on foreign acquisitions, increased scrutiny of foreign investments in sensitive sectors, and the establishment of new regulatory bodies to oversee foreign investment (Zheng 2023).

It is worth noting that China has not imposed specific regulations on EU investments in response to the EU's screening mechanism. However, China has taken steps to tighten its overall regulatory environment for foreign investors, including those from the EU. Therefore, while China has not specifically targeted EU investments in response to the EU's screening mechanism, the country's overall regulatory environment for foreign investors has become more restrictive in some industries in recent years, posing challenges for EU businesses seeking to invest in China.

5. Economic policies in the EU

Changes in the perception of globalization have led to a new European approach to economic policies, as evidenced in two trade strategy documents released in 2021. Both emphasize the need to support and actively protect the European industry from foreign countries' trade practices (Youngs and Ülgen 2023 54).

The evolving perspective of the EU on globalization not only reflects its stance on trade and FDI but is also increasingly intertwined with environmental and climate concerns. As the EU adopts a more cautious and protectionist approach in response to external factors such as the U.S.-China trade war, it concurrently underscores the need for sustainable and responsible trade practices. Overall, trade policies are not as important as industrial policies in the new EU approach to globalization, but it does play an important role in climate policies.

More specifically, green clauses have become a crucial aspect of recent bilateral trade agreements negotiated by the EU. For example, during trade negotiations with ASEAN, the EU demanded a cap on biofuel exports from Indonesia and Malaysia and an end to deforestation (Youngs and Ülgen 2023, 54). Similarly, some European countries have been hesitant in trade talks with Mercosur due to Brazil's policies in the Amazon. The most significant way that climate considerations have impacted European trade policies is through the introduction of the Carbon Border Adjustment Mechanism (CBAM). EU's climate tariffs are designed to tax imported goods from countries without stringent climate policies comparable to those of the EU. The goal of these tariffs is to level the playing field and encourage other countries to reduce their greenhouse gas emissions.

Climate tariffs have substantial implications for global trade, primarily because the EU is a large economy and accounts for a significant share of global trade. The tariffs target goods from heavily polluting industries, such as steel, cement, and aluminum, and are based on the carbon footprint of the imported goods calculated from the emissions associated with their production, transportation, and disposal.

The EU’s climate tariffs have sparked discussions and debates both within and outside the union. Internally, the debate has centered on how to use the revenue generated from the tariffs. Some proponents argue for reinvesting the revenue in clean energy and climate mitigation efforts, while others suggest supporting workers and industries negatively impacted by the tariffs.

External critics of the EU’s climate tariffs argue that they are protectionist measures that could lead to retaliation from other countries and damage global trade. The issue of administrative complexity, particularly for developing countries, has also been raised as a significant concern. The implementation of CBAM requires a complex administrative system to track emissions and calculate the carbon content of imported goods (Cosbey et al. 2019). This could be challenging to implement, especially for countries with limited resources and expertise (Mehling et al. 2019). One potential solution could involve the EU providing technical and financial assistance to developing countries, helping them build capacity for measuring and reporting carbon emissions. Additionally, the EU could streamline administrative procedures for CBAM to reduce the burden on both importers and exporters. Another concern is the inequitable burden-sharing: CBAM places a burden on exporters from developing countries, which may have limited resources to transition to cleaner production methods (Eicke et al. 2021). This could exacerbate existing global inequalities and disproportionately burden those least responsible for climate change. The EU could work with other countries to establish a global fund to support developing countries in transitioning to cleaner production methods and offer preferential treatment for imports from countries that demonstrate progress toward reducing carbon emissions.

Lastly, the implementation of CBAM could be perceived as a unilateral action by the EU without global consensus on climate policies. This could undermine international efforts to combat climate change and harm the EU's credibility as a global leader in climate action. To avoid this outcome, the EU could work with other countries to establish a global framework for carbon pricing and trade policies, building on existing initiatives such as the Paris Agreement and promoting dialogue and cooperation between nations.

6. Industrial policy and the return of the state

As previously mentioned, the change in the EU's attitude toward globalization is primarily reflected in its view on the state's role in the economy and in a new, active, and selective industrial policy. The EU consists of 27 member countries, each with its own perspectives on various economic and political aspects, including trade and industrial policies. The EU's policies are the result of negotiations and compromises, with larger countries having a more significant impact on the final outcome. Europe has always been divided on economic policies, with the south being more positive toward state involvement than the north. Two factors have shifted the balance toward more state involvement. Firstly, Brexit resulted in the departure of the EU's strongest advocate for free trade and limited government involvement in the economy. Secondly, Germany's attitude has shifted from being market-friendly to strongly leaning toward state-led industrial policies. This change might be due to concerns about the industrial sector's ability to handle increased international competition in general, and specifically, how Germany's critical automotive industry will adapt to electrification challenges.

Additionally, many Europeans seem to view the state-led development in China and increased government involvement in the United States as favorable policies worth following. Finally, the war in Ukraine highlighted the cost of being dependent on imports of essential goods from undemocratic and potentially hostile nations, such as oil and gas from Russia. This last aspect has also led to renewed discussions on imports from China and the possible dangers of Chinese FDI in Europe, as discussed earlier.

The change in Germany's attitude toward industrial policy was clearly manifested in the government's launch of a new policy in 2019 (Altmeier 2019). This policy signified strong state involvement and an active role in shaping the economy. One of the most striking aspects of the plan was the inclusion of specific quantitative targets for the industrial sector's size, aiming to increase its contribution to GDP from the current 23 percent to 25 percent. This is a high figure compared to many other countries. For instance, the industrial sector accounts for around 12 percent of GDP in the United States.

The report offers a few suggestions on how the industrial sector could be supported (Zettlemeyer 2019). Firstly, local and regional supply linkages should be encouraged and replace global ones. Although it is unclear how this can be achieved, given that such decisions are made by firms rather than policymakers, there are occasional suggestions of quotas on the use of non-EU inputs for producing goods deemed particularly valuable. Furthermore, strategically important firms should be provided with support (in the form of subsidies), and EU competition law must be amended to enable such policies. Additionally, foreign acquisitions of domestic (German) companies require thorough screening. According to the report, the government should also have the ability to prevent foreign acquisitions of domestic

firms by purchasing stocks in the targeted companies. Finally, selective support to industries with essential characteristics is present in the German industrial plan.

The German policy represents a break from a previous market-oriented view and has a significant impact on the rest of Europe. France and Germany are the largest economies in Europe and have a dominant weight in deciding the union's development path. Consequently, Europe is turning more inward-looking and becoming less enthusiastic about the free market. Ursula von der Leyen, President of the European Commission, has proposed several measures to bolster the EU, all of which demonstrate a strong belief in the state's ability to foster growth and competitiveness. In 2020, the EU Commission unveiled an industrial plan emphasizing the importance of, and need for, selective industrial support. Furthermore, the European Microchip Act and a fund for semiconductor development were introduced in 2021. Many German policies were reflected in these EU initiatives. Key industries targeted by the plan include raw materials, batteries, semiconductors, hydrogen gas, and various digital applications.

In September 2022, the launch of the Investment Reduction Act (IRA) in the United States sparked concern within the EU. The IRA aims to significantly reduce greenhouse gas emissions, helping the United States move closer to its target of a 50 percent reduction by 2030. Ideally, a carbon pricing approach, similar to the EU's Emissions Trading System (ETS), would have been implemented, but political challenges hindered its adoption. The IRA offers subsidies for electric vehicle purchases, clean-tech production (including batteries and components for renewable electricity generation), and the production of carbon-neutral electricity, hydrogen, and other clean fuels (Kleinman et al. 2023). The IRA violates WTO

regulations, as only U.S. producers are eligible for subsidies, and a local content condition applies to both finished goods and input components.

The EU fears that the IRA will shift clean-tech production to the United States, both to access subsidies and take advantage of low energy prices resulting from the IRA. This is particularly relevant for the motor vehicle industry. The IRA is expected to reduce production costs of electric cars in the United States by around 20 percent (Kleinman et al. 2023), which could drastically decrease EU car exports to the United States and prompt European car manufacturers to relocate production to the United States. Consequently, while the EU welcomes the U.S.'s renewed focus on climate change, there is widespread concern that the policies will harm EU industries in general and its advantage in green industries and innovations in particular (Holtzhausen 2023).

The IRA has consequently spurred new waves of EU policy measures, such as the "Green Deal Industrial Plan" and the "Net Zero Industry Act." These initiatives parallel the IRA in their support for environmentally friendly industries. The funding allocated for subsidies and other assistance is roughly equivalent to that in the United States, closing the gap with the EU, which has provided substantial subsidies for a relatively long time, and the United States.[8]

The practice of setting quantitative goals for industrial policies, as seen in Germany, is also evident in the EU's latest moves. For example, the EU has set a goal to domestically produce at least 40 percent of the technology needed to achieve its climate and energy targets by 2030.

[8] For instance, in 2017, EU subsidies for renewable energy production were eight times higher than those in the United States (Confederation of Swedish Enterprise and Copenhagen Economics 2023).

This intertwines climate and industrial policies in a manner that is likely unfavorable for both the environment and broader industry.

A primary concern with the recent EU initiatives is the relaxation of state aid rules. One potential downside of this new approach to subsidies is that it may threaten the very foundation of the single market. Subsidies are predominantly found in large and wealthy countries, particularly France and Germany, putting firms from smaller and poorer countries at a disadvantage. It is also highly questionable whether increased subsidies will have a long-term positive impact on productivity growth and competitiveness in the EU.

Another facet of the subsidies is their conflict with EU policies regarding foreign countries. As previously mentioned, the EU has long advocated for stricter measures against trade-distorting subsidies and state-owned enterprises. In 2022, a foreign subsidy regulation was introduced to protect European firms from what was perceived as unfair competition from foreign subsidized firms. The evolving European policies will undoubtedly make pushing for changes in foreign government subsidies much more challenging.

7. Concluding remarks

The EU and the world are becoming more inward looking, which is likely to lead to lower economic growth and lower living standards (Irwin 2019; Chari et al. 2021). For instance, unlike in the United States and the UK, this development does not seem to be caused by distributional aspects of globalization. Instead, the change in attitude is presumably a result of the global context. For instance, the trade war between the United States and China has had a significant impact on the EU, both economically and politically. The EU has been caught in

the middle of the conflict, struggling to balance its economic interests with its political concerns about maintaining a stable global trading system. These developments have led to a complex and delicate relationship between the EU and China, with both sides navigating between cooperation and conflict.

At the same time, the EU has been reevaluating its own economic policies, with a renewed focus on industrial policy and the role of the state in fostering growth and competitiveness. The EU's new industrial plan emphasizes the need for selective industrial support, including subsidies and screening of foreign acquisitions of domestic firms. There is also a growing focus on climate policies and environmental considerations in international trade, including the introduction of the CBAM.

It remains to be seen how these tensions will evolve in the future and whether the EU will be able to strike a balance between protecting its interests and engaging with China and the United States as a global economic and political power, while also pursuing its own economic and environmental goals. The EU's evolving industrial and climate policies will undoubtedly play a role in shaping this balance, as will the ongoing dynamics of global trade and geopolitics.

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