CHAPTER 3

The Return of Borders in the World Economy: An EU-Perspective

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Introduction

Almost 20 years ago, Thomas Friedman (2005) described in his best-selling book how the world appeared to be "flat" with no major barriers to the movement of goods and people between countries. National borders were said to be a relic of a bygone era and of no practical significance. This was in many ways a fair and accurate description of the world as it was at the time of writing, but it was also the end of an era of ever-increasing globalization. Two events in 2016 provided definitive proof that this was the case. In June, the United Kingdom voted to leave the European Union (EU), a lengthy process, as it turned out, that was not

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completed until more than three years later. On the other side of the Atlantic, in November of the same year, Donald Trump was elected President of the United States after campaigning on the slogan "Make America great again", which would be achieved through more inward-looking economic policies.

These developments reflect a return to the importance of geographical borders, both between the EU and the rest of the world, as well as within the EU. More specifically, trade between the EU and the rest of the world faces higher tariffs and more of other types of trade barriers, and trade within the EU has also encountered obstacles, such as trade in medicine and health-related products during the coronavirus pandemic. The seeds of this development were sown decades ago. Already in the 1990s, we started to see a change with the emergence of anti-globalization movements backed by both intellectuals (e.g., Klein, 2000) and violent groups that literally fought for their ideas in Genoa, Seattle and Gothenburg. The gradual impact of these ideas meant that for the first time in decades, globalization seemed to stall. In particular, after the 2008–09 financial crisis, an increasing number of countries started to introduce various types of trade barriers, in stark contrast to the trade liberalization of the previous decades (Evenett & Fritz, 2019).

The EU has a tradition of promoting a rules-based and open trade policy. This stance is being challenged by the protectionist measures introduced in both the US and China. An aggravating factor is that the World Trade Organization (WTO) has been damaged by international conflicts. At the same time, we are also seeing increased protectionism within the EU, which in turn can damage the very foundations of the Union.

This chapter ventures to unravel a perplexing question: In light of these transformative events and the rise of protectionist measures, how should the EU navigate its trade and economic policies? Particularly, does the EU's burgeoning emphasis on a selective industrial policy, favouring certain sectors over others, risk stunting its growth and prosperity? Or should the Union reconsider its stance and steer towards embracing an open, rules-based global trade regime?

The main argument of this chapter is that the EU's emerging strategy of a more active industrial policy, whereby authorities select companies and industries for special support and protection from competition, is negative for growth and prosperity. Instead, the EU should open its borders. This applies to both internal borders, to ensure a well-functioning internal market, and external borders, to work for a global open and rules-based trade regime.

This chapter relates to the book's overall theme of borders by discussing the reasons for the decline of globalization, the increasing importance of borders and the implications for the EU. I start by showing how globalization has stalled and continue with a discussion of what drives globalization, which is then used as a basis for explaining current developments. Developments in the EU are largely influenced by what is happening in China and the US, which is why I discuss the view on globalization in these two countries in the next two sections. The chapter then continues with a description of the shift in the view of globalization that can be discerned in the EU, after which a concluding section offers a number of different policy recommendations.

The Era of Ever-Increasing Globalization Is Over

The decline of globalization is illustrated, for example, by the development of world trade in Fig. 3.1. World trade rose from just under 30% of world income (GDP) in 1970 to just under 40% in 1990. With the collapse of the Soviet Union and the progress of market economies around the world, world trade then increased to 60% in 2007. The 2008–09 financial crisis caused a sharp but rather short-lived decline in trade. However, after the upturn in 2010, the share has stagnated, being 57% in 2021, roughly the same level as in 2005. Part of the global decline in trade is due to the COVID-19 pandemic, but it is worth noting that the share of trade declined even before the pandemic. There are exceptions to the general pattern of a relative decline in international trade, including in the EU where trade has increased slightly after the financial crisis (Sjöholm, 2023).

A very large share of international trade is carried out by multinational companies, which have been a key player in globalization. Figure 3.2 shows foreign investments by multinational companies as a share of GDP. These grew quite modestly from 1970 to 1990. As with international trade, direct investment as a share of GDP then increased, reaching over 5% in 2007. The financial crisis brought a decline to around 3% of GDP and investments have since stagnated or even decreased in importance.

When discussing the rise and fall of globalization, it is crucial to first understand what drives it. As Baldwin (2006) elucidates, the development

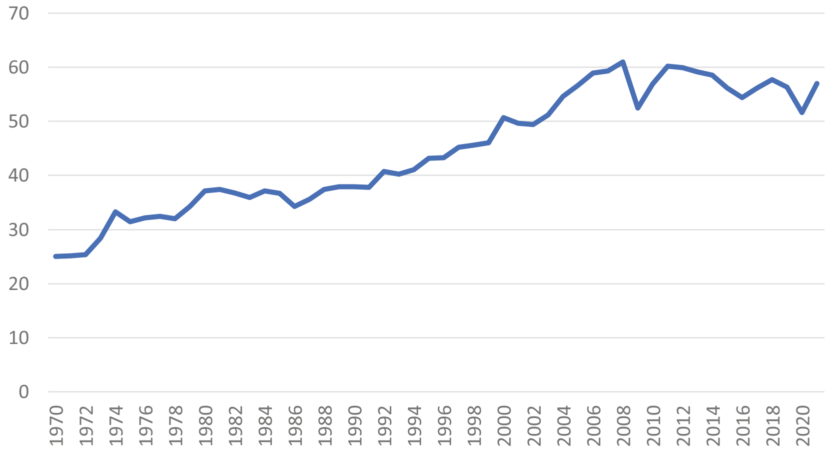

Fig. 3.1 International trade as a share of GDP 1979-2021 (%). *Source* World bank development Indicators. https://data.worldbank.org/indicator

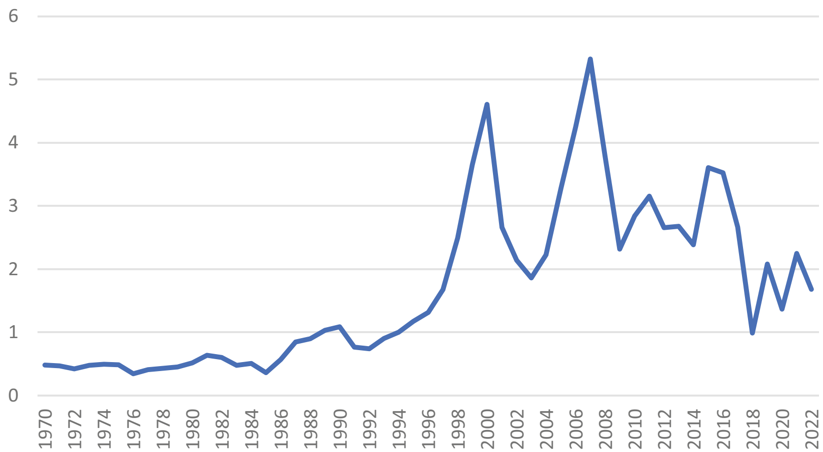

Fig. 3.2 Foreign direct investments as a share of GDP 1970–2022 (%). *Source* World Bank Development Indicators. https://data.worldbank.org/indicator/BX.KLT.DINV.WD.GD.ZS

of globalization can be broadly segmented into two overarching determinants. The first revolves around the political will for augmented global integration; the strength of a nation's inclination for trade and integration directly dictates its engagement level. This political intent subsequently shapes a nation's tariffs and trade barriers. The second determinant pertains to the capability to transfer goods and services across borders, often steered by technological advancements. The drive for global integration has surged since the mid-twentieth century, with the creation of the EU exemplifying this trend. The EU has successfully implemented a plethora of measures and reforms to promote the seamless movement of capital, labour, goods and services across member states. According to Moravcsik (1998), the EU's accomplishments include not only economic integration but also the enhancement of political stability and the establishment of shared regulations and standards, making it a benchmark for integration worldwide. These achievements have clearly served as an inspiration for other regions, prompting the development of integration projects like ASEAN in Southeast Asia, NAFTA (now USMCA) in North America and Mercosur in South America.

Parallel to increased regional integration, such as the EU, there has been a significant effort to increase global integration. This has been supported by the establishment and work of international organizations such as the WTO (formerly GATT), which has been successful in reducing tariffs and trade barriers between its member countries. The political will to increase trade and reduce protectionism has both political and economic explanations. In particular, the creation of the EU had the stated aim of preventing future wars through greater economic integration in Europe. In terms of economic explanations, it became increasingly clear in the decades after World War II that increased growth and living standards were difficult to achieve with protectionist economic policies. This shift in thinking about international integration has been gradual. In the 1950s and 1960s, many academics and politicians advocated a development strategy based on domestic industrial expansion under the protection of high import tariffs (Krueger, 1978). The experience with this so-called import substitution policy was in many places very negative, leading countries to open up to trade and capital flows. This is a development we have seen since the 1990s in some of the world's most populous countries such as China, India, Brazil and Indonesia and which has had a major impact on global production and trade patterns.

Technological progress and improved infrastructure are other important determinants of the increased globalization. Moving goods and services between countries requires affordable transportation. About 80% of world trade is carried by sea and the development of container traffic has greatly reduced transportation costs and increased trade (Bernhofen et al., 2016). Similarly, the deregulation of air travel in many countries since the 1980s has led to increased trade in goods that need relatively fast transport.

The development of information and communication technologies (ICT) has also had a major impact on trade. In particular, it has opened up trade in services, which was previously very difficult as proximity between production and consumption was necessary. Before the digital revolution, it was said that anything that can be packed in a box can be traded, nowadays it is anything can be sent as an attachment to an email.

Falling transport costs and the development of ICT services have also affected the way companies organize their activities. Multinational companies in particular have fairly complex structures. Production chains have developed where different components are produced in different countries, leading to increased efficiency and reduced costs. The production of components usually takes place both in the company's own foreign plants and in independent companies. Overall, this has led to an increase in the volume of trade but also to a change in the structure of trade, with more trade in inputs and relatively less trade in finished products. Finally, a significant share of world trade takes place between multinational companies' establishments located in different countries.

Why Has the Political Will Changed?

The discussion above highlights the importance of technology and political will in the development of globalization. So why has globalization stagnated? It is not because of technological developments, which on the contrary continue to open up new sectors for international trade (e.g., Baldwin, 2016). Instead, the political will for globalization has diminished and in some places been replaced by much more inward-looking policies. This leads to the next question—why are we seeing a change in the political attitude towards globalization?

A first attempt at approaching the issue is provided in Fig. 3.3, which shows the shares of three regions in the world economy: Europe, the US and East Asia. Europe and the US each accounted for just over a third of the world economy in 1970 and East Asia only 14%. The share of the latter region increased continuously until the mid-1990s when it stabilized at a level of around 20–25%. After the financial crisis of 2008–09, East Asia's share increased again and was about one-third of the world economy in 2020. At the same time, the shares of Europe and the US have decreased to around 25% each. Asia's increased relative size is largely due to China's high growth. Between 1979, when the country started reforming, and 2021, growth has averaged 9% per year, which in turn has led to China's share of the world economy increasing from around 2 to 17% over the same period.

This change has had both political and economic effects. On the political side, it is clear that in recent years China has pushed its global interests harder. China has advanced its positions in the South China Sea, increased pressure on Taiwan and crushed the relative freedom of Hong Kong. The repression of Uyghurs and other minority peoples can be added to this development, which has led to increased geopolitical conflicts. This is one reason behind a more cautious approach to globalization in many countries.

The economic development also reflects significant changes in production pattern. After joining the WTO in 2001, China's exports increased

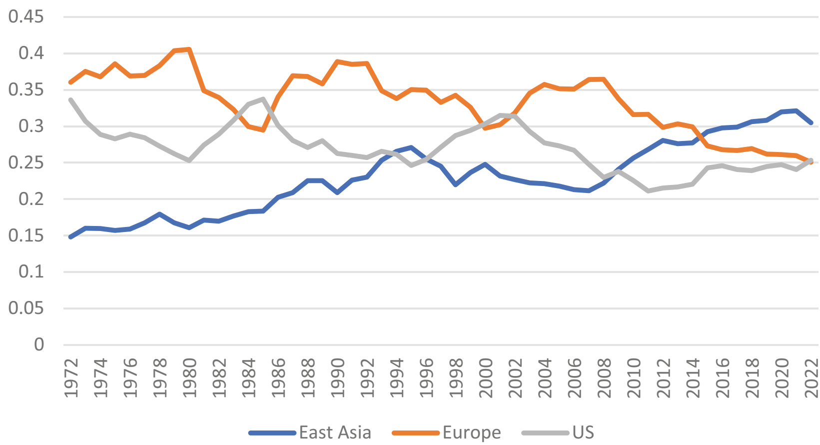

Fig. 3.3 The share of global GDP in different regions 1970–2022 (%). *Source* World bank development indicators. https://data.worldbank.org/indicator/BX.KLT.DINV.WD.GD.ZS

sharply. In ten years, China's share of world exports increased from less than 5% to more than 15%. This led to major socio-economic gains but also to structural changes. Above all, much of the industrial production has moved out of Europe and the US to China. In the literature, the concept of job polarization has been established to denote a development where low- and high-wage jobs increase their share of total employment and middle-wage jobs decrease in importance. Such developments have been documented in many countries (e.g., Heyman, 2016). While the trend has, somewhat surprisingly, had a modest impact on income inequality in most EU countries, it has meant that parts of the workforce in the US and UK, for example, have seen their real wages fall.[1]

This job polarization has had political consequences. At a general level, we see that populist parties have grown in importance in a large number of countries on many continents (Rodrik, 2017). Within EU member states, around one-fifth of citizens vote for what can be characterized as populist parties. In 2022, the election of Giorgia Meloni as Prime Minister of Italy was a sign that populism continues to thrive in Europe.

The existing research literature does not show that increased globalization always increase support for populist parties (Bergh & Kärnä, 2021), but there are studies on individual countries that find a causal relationship between globalization and various specific political effects that are sometimes referred to as populism (e.g., Dippel et al., 2015). In particular, Autor et al. (2020) show that it led to increased political polarization in the US. Their results show that the surge in Chinese imports to the US has affected voters' political preferences. More specifically, Democratic voters in districts negatively affected by Chinese imports have become more left-leaning in their views. Even stronger is the effect on Republican voters in districts affected by the import shock, who have moved to the right to the Tea Party movement and to the Donald Trump camp.

Another study by Colantone and Stanig (2018) finds that globalization contributed to Brexit. International trade was not debated in the election campaign. The major issue was rather national self-determination from Brussels, as evidenced by the Yes-side's motto "Bring back control." But the negative view of the EU was very much influenced by economic factors, which in turn were affected by globalization. Imports from China negatively affected parts of the population and led these people to vote

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

relatively strongly in favour of leaving the EU. In the election, 52% of the population voted in favour of leaving, but there were large differences between different parts of the UK. More specifically, the share of yes-votes was high in regions that produced goods that competed with Chinese imports. This was the case, for example, in the traditional industrial towns in central and northern England. At the other end of this spectrum is London, whose labour market was hardly affected at all by Chinese imports and where the no-vote was in the vast majority. Of course, the EU has nothing to do with Chinese imports, which may make the voters' choice seem illogical. A reasonable explanation is that both imports and the EU were associated with globalization, which evokes negative associations in those parts of the population affected by its negative aspects.

The war in Ukraine has also affected the EU's approach to trade and borders. In particular, the war has resulted in the closure of the border with Russia. Many EU member states are refusing entry to Russian citizens. Perhaps even more importantly, the trade boycott against Russia and Belarus was introduced fairly soon after the outbreak of the war and has since been tightened in various stages. Before the war, Russia was the EU's fifth-largest trading partner. At the same time, the EU was the largest trading partner for Russia, Belarus and Ukraine. This means that the trade boycott against Russia and Belarus has a significant impact on the economies of these countries, as described by Becker and Åslund in their chapter. It also means that the trade liberalizations with Ukraine that started before the war and deepened in 2022 are important and of more than symbolic value.

Finally, the change in economic policies in the EU depends to some extent on the development in China and the US. Both these countries have become increasingly inward-looking, which has had a direct effect on the EU. We therefore continue by discussing below how views on globalization have evolved in China and the US.

The US Turns Its Back on the World

Donald Trump has always seen trade as a way to move income and jobs between countries, and he entered the 2016 election campaign with a clear protectionist line (Jones, 2021). More specifically, his core instinct seems to be that any trade deficit is due to other countries manipulating prices and exchange rates, thereby stealing income and jobs from the US.

If there were any doubts whether Donald Trump would actually implement protectionist policies, they were dispelled almost immediately after he took office. On his first day, he withdrew from negotiations on a free trade area in the Pacific region. This alone was not so controversial. President Barack Obama had failed to gain support for the plans during his presidency and Hillary Clinton said during the presidential campaign in 2016 that she was willing to scrap the project. However, this was only the beginning of a policy that drastically changed US trade policy. In 2017, a renegotiation of the Free Trade Agreement with Canada and Mexico (NAFTA) was initiated. President Trump was unhappy that the US was running trade deficits with both Mexico and Canada and made the usual claim that it was costing the country jobs and revenue.

New protectionist programs followed (Bown & Kolb, 2020). In 2018, for example, tariffs were imposed on almost all steel and aluminium imports, all under the slogan "If you don't have steel you don't have a country." This affected a wide range of countries on many continents. Other types of protectionist measures were also introduced, and the most significant trade dispute was with China. Donald Trump successively imposed high tariffs on almost all imports from China. The average tariff on Chinese imports rose from around 3 to 24%. China responded by raising tariffs on US imports from around 7 to 26%. The trade conflict was about to escalate out of control when, in 2019, the parties reached an agreement that cooled the worst of the conflict and stabilized the situation, albeit at a high protectionist level. More specifically, the average US tariff on Chinese imports was then around 20% and the average Chinese tariff on US imports around 19%. But the deal was deeply problematic by design. In particular, it included quantitative import targets for Chinese imports from the US. In other words, China committed to import certain specific products of a certain value from the US. One difficulty with such a procedure is that it is not states but companies that trade with each other and it is not obvious that there are American companies that want to sell these products to China and Chinese companies that want to import. An even more problematic aspect of quantitative targets is that they obviously risk affecting other countries' exports to China.

The change in US trade policy has resulted in economic costs for the US and the rest of the world. Import tariffs imposed by large countries such as the US are theoretically paid for either by domestic consumers who have to pay more for imported goods and services, or by foreign producers who may be forced to reduce prices when demand falls. Studies show that in the case of the US, prices have been passed on to American consumers (Amiti et al., 2019; Redding et al., 2019). When import prices go up, workers cannot consume as much as before. Real wages and welfare for US citizens have therefore declined. The idea behind the policy was possibly that higher prices could be a cost worth taking if the number of American industrial jobs increased. But prices have risen without much job creation, and Amiti et al. (2019) estimate that each new job has costed $195,000 in reduced welfare, or about four times the average annual income of steelworkers, an occupational category often mentioned in the US trade policy debate.[2]

The biggest cost of US protectionist policies is the erosion of the rules-based trading system that has successfully governed international trade over the past decades. US policy changes have been in direct conflict with the WTO rules system: the US has threatened Mexico with import tariffs unless its migration policy is changed, pressured South Korea to impose voluntary export restrictions on steel, used security arguments to impose tariffs and violated the WTO principle of non-discrimination between members when China was pressured to impose quantitative targets on US imports.

Canada, the EU, China and Mexico have in turn responded by imposing their own tariffs on imports from the US, tariffs that also violate WTO rules. The consequence is that the WTO is playing a diminishing role in world trade. There are, of course, other reasons for the WTO's decline, such as its apparent difficulty in reaching new multilateral trade agreements. The latest round of negotiations, the Doha Round, has been ongoing since 2001. But the trade war has made it even more difficult for the WTO to operate. So has another US practice that cripples the WTO's operations—blocking the appointment of new judges, which is necessary to resolve trade disputes between member countries. The US has traditionally been reluctant to let decisions affecting it to be made by an international court. One way to hinder the court's work is to veto new judges to replace those who leave. This procedure was already used on a few occasions during President Obama's time in office but was used more consistently and wholeheartedly by President Trump. Nowadays, the WTO dispute settlement mechanism does not work.

[2] One reason for the importance of the steel industry in US trade policy is that this industry is important in swing states, states that are particularly important to win in US elections (Bown, 2019).

President Joe Biden can be said to have put forward a new ideological basis for his foreign policy, talking about making a common cause with other democracies (Wong & Swanson, 2022). This policy has been reinforced by the Ukraine war. But Biden also talks about making life easier for the middle class by encouraging American companies to bring back production from China in particular, a clearly protectionist policy. Tariffs imposed by President Trump remain in place, and no real broader attempts to return to the situation before the trade wars have been initiated. Rather, new trade barriers are being introduced, such as a ban on exports of high-tech goods to China and on the import of goods produced in whole or in part in Xinjiang, a province where Chinese authorities commit abuses against the indigenous population (Zenz, 2019). Furthermore, the US continues to block the work of the WTO. Thus, the US protectionism introduced under President Trump remains in place and there are no clear indications in 2023 that the situation is about to change.

The Chinese Wall

It is hardly surprising that China is the main target of the US in its changing trade policy. The EU, the US and many other individual countries are united in their dissatisfaction with China's trade policy. When China joined the WTO in 2001, there was a relatively broad expectation that the country would take further steps to liberalize and become more of a market economy. This has not been the case and the country is characterized by a state capitalist system that is difficult for the WTO to deal with and which is causing great irritation to the outside world.

The first problem is the large subsidies paid to Chinese companies, which means that companies from other countries do not compete on equal terms. These subsidies are most evident in the case of state-owned enterprises, which are of great importance in China. For example, of the world's 500 largest companies in 2020, 130 were Chinese, a sharp increase from only 15, fifteen years earlier (Huang & Véron, 2022). Even though private Chinese companies have increased their share of the list, state-owned enterprises still dominate the list with about 75% of the number of companies and 80% of the revenue.

State-owned enterprises are often pressured by the authorities to achieve objectives other than purely economic ones, such as avoid laying off workers or participate in different types of projects. In return, the company gets access to a variety of support from the authorities. Private companies also receive support if they follow government instructions. Since the Chinese state controls access to land and capital, for example, this is rational behaviour on the part of companies.

One consequence of the system is that, due to subsidies, a very large surplus capacity has been built up in Chinese industry, which depresses world market prices and affects foreign companies (Lai, 2021). The mechanism behind the excess capacity is in turn a result of the Chinese political system pushing for more and more investment to sustain economic growth (Chen et al., 2021). Chinese leaders at all levels need to deliver high growth to advance within the state bureaucracy. Ideally, growth in their own region, city or district should be higher than growth elsewhere. Pushing companies to sell more is difficult, but pushing for increased investment in machinery, premises and technology is more feasible. The result, as mentioned above, is an industrial capacity that far exceeds what can actually be sold on the domestic market or exported.

Another problem concerns the lack of transparency, which makes it difficult for the WTO to intervene. An illustrative example is China's production of aluminium products. Coal production is subsidized, which leads to lower prices for aluminium. In turn, aluminium producers are prohibited from exporting their production, which leads to lower prices for Chinese users of aluminium, that is, producers of various aluminium products. Finally, exporters of aluminium products pay lower taxes than other Chinese companies. Taken together, these measures constitute a significant but hard-to-identify subsidy for Chinese exporters of aluminium products and a negative competitive situation for foreign producers. Similar arrangements exist in other industries.

The third major problem concerns technology issues. Accusations that China improperly appropriates foreign technology are regularly made by other countries. It is common for less developed countries to use foreign technology in their industrialization efforts. What makes the Chinese case different from the experience of many other countries is that the state is said to be (more) involved and that technology transfer to Chinese firms is said to be institutionalized. There are often requirements that foreign companies cooperate with local Chinese companies, use local subcontractors, conduct research and development in China and use the latest technology in their Chinese operations. Overall, the requirement for technology and local Chinese partners is said to lead to the diffusion of firm-specific technology to Chinese competitors.

There is reason to believe that China will become more inward-looking in the future. The "Made in China 2025" strategy launched in 2015, and the "Dual Circulation" strategy included in the 14th five-year plan for 2021–2025, stress that China will become less dependent on the outside world by producing more inputs and especially more technologically sophisticated products. In reality, China's dependence on foreign markets has already decreased. For example, the share of exports in GDP has halved in the last 15 years to a modest 17%. Chinese economic policy aims to enable the country to make the difficult transition from a middle to a high-income country. China should become less of a country with a competitive ability to assemble imported inputs into finished products for export. Instead, the domestic share of value added will increase. This requires significant technological upgrading. The hope is that Chinese high-tech companies will emerge and grow as a result of an appropriate combination of subsidies and protection (Sjöholm and Lundin, 2010).

The EU Turns Inward

Developments in the US and China have affected the EU and its approach to globalization. In the case of China, the European view is that there is no level playing field and that China, through subsidies and trade barriers, unfairly favours domestic companies at the expense of European companies. Furthermore, increased US protectionism has led to European tariffs on imports from the US and, perhaps more importantly, to a reduced belief in free trade. Contributing to the rise of protectionism is also the view in some quarters that large state-led industrial initiatives in China and the US, which include protection from foreign competition, are successful and should be replicated in the EU.

Traditionally, the EU has advocated free trade, although there are exceptions, such as agricultural policy. The EU has also been a driving force in global trade liberalization and the development of the WTO. Finally, over the last 20 years, the EU has concluded bilateral trade agreements with Chile, Egypt, Georgia, Israel, Japan, Mexico, South Korea, Ukraine, Singapore, Canada, South Africa, Vietnam and New Zealand.

But the situation has changed. Some important trade liberalization negotiations collapsed in the second half of the 2010s, most notably the 2016 free trade agreement negotiations with the US and Canada. Negotiations with China have also encountered difficulties. A 2020 investment agreement has faced increased political resistance and has in 2023 not yet been approved by EU member states.

The EU also broke its tradition of promoting a rules-based trading system when it responded to rising protectionism in the US by imposing tariffs on US imports. Under the leadership of European Commission President Ursula von der Leyen, the EU has moved in a more interventionist and protectionist direction. The European Commission talks about tariffs on imports from countries that subsidize their production, while advocating an industrial policy that will foster successful companies in sectors considered to have high growth potential. The EU has also increasingly talked about taking into account a variety of issues, such as child labour and the environment, in its trade policy.

The war in Ukraine has contributed to a growing concern in the EU about being dependent on vital imports from authoritarian countries. The dependence on Russian oil and gas led to a severe energy crisis after the war broke out and imports from Russia declined (see Becker and Åslund, Chapter 7, this volume). Similar concerns are increasingly voiced over imports from China, and there is a discussion on the possibilities of moving production home to the EU or to more friendly countries (Goldberg and Reed, 2003). This is one example of how trade and security issues are increasingly intertwined.

An increased degree of introspection in the EU is even more due to the fact that China and the US appear to be successful in some areas of their industrial policies. As mentioned earlier, China has used subsidies and other measures to support domestic companies, and in the US, government industrial policy has also become more important. A general concern in the EU is that its companies are perceived as lagging behind competitors in other countries, in particular in so-called high-tech industries. An increased focus on industrial policy is seen in the early 2020s both in the EU and in individual member states. The fact that these sentiments are heard in France is in line with a long tradition in the country, but it is surprising to hear similar arguments in Germany. In 2019, Germany launched a strategic plan for German and European industries (Altmeier, 2019). The plan focuses mainly on the manufacturing industry rather than, for example, the service industry, and the policies advocated are strongly interventionist (Zettelmeyer, 2019).

More specifically, the plan mentions quantitative targets for the size of the industry. For Germany, the target is 25% of GDP and for the EU 20%, an increase from the current 23% and 14% respectively. These are high figures for countries at such high-income levels. In comparison, the share in the US is about 12%.

The plan aims to achieve the objective of a larger industrial sector through a number of measures (Zettlemeyer, 2019, p. 1).

- Purchases of inputs will be increasingly sourced from companies within the EU. Value chains will therefore be regional rather than global.
- Companies that are considered particularly important will receive various forms of support. For example, it is proposed that competition law be changed to make it easier for these companies, even if it means less competition in the European market.
- Foreign takeovers of domestic companies can be stopped by the state buying up shares in private companies.
- Key industries should be identified and supported.

The above measures represent a significant regime change in the European view of what the market should stand for and what is the role of the state. It also implies a changed view of globalization where openness to trade and foreign direct investment is replaced by a more inward-looking policy. Exactly how much of the measures that actually will be implemented is uncertain, but it is clear that the idea of a more interventionist industrial policy has gained a foothold and is spreading across the Union. It is also interesting that the measures are not based on market failures, a standard argument for state interventionism. Rather, there is a more fundamental belief in the ability of the state to bring about changes in a positive direction, changes that private industry is not believed to be able to bring about on its own. That this would be the case seems highly uncertain. Identifying future important projects is difficult for both the state and companies, but the latter are much better at dismantling unsuccessful initiatives (Zettlemeyer, 2019, p. 11). When the state makes targeted investments that do not pay off, various interest groups tend to make it difficult to dismantle the project in question.

The European Commission's 2020 industrial policy strategy echoes many of the German proposals. Again, the emphasis is on selective packages of measures to target certain companies and industries. In terms of strategic industries that the EU wants to focus on, important raw materials, batteries, hydrogen, processors and semiconductors, industrial data, cloud and e-services and circular plastics are mentioned (Flam, 2021, p. 4). It is questionable how many of these industries have the potential to be competitive in the EU. A likely future global overcapacity in for instance semiconductors will be a difficulty for European production and in the case of batteries the market seems to be able to meet demand without government subsidies (*ibid*).

In 2022, the US' introduction of the Investment Reduction Act (IRA) stirred unease within the European Union. Aimed at significant cuts in greenhouse gas emissions, the IRA positions the US closer to its 50% reduction goal by 2030. The IRA subsidizes purchases of electric vehicles, clean-tech production and production of carbon–neutral fuels, exclusively for US producers (Kleinman et al., 2023). This exclusion, however, contravenes World Trade Organization regulations.

The EU is anxious that the IRA might catalyse a shift of clean-tech production to the US, lured by subsidies and low energy prices. This anxiety is pronounced in the automobile industry, given the IRA's potential to slash US electric car production costs by 20%, thereby threatening EU's car exports and possibly leading European manufacturers to move operations to the US (Kleinman et al., 2023). Thus, while the EU appreciates the US's renewed environmental commitments, it fears potential damage to its green sectors (Holtzhausen, 2023). In response, the EU has launched initiatives like the "Green Deal Industrial Plan" and the "Net Zero Industry Act," providing support comparable to the US's support of its green industries.

In addition to internal support initiatives, the EU is also exploring external measures to safeguard its green industries and ensure a level playing field. One notable mechanism is the proposal of the EU's Carbon Border Adjustment Mechanism (CBAM), commonly referred to as "climate tariffs." Designed as a part of the European Green Deal, the CBAM aims to impose taxes on carbon-intensive products imported from countries with less stringent environmental regulations, thereby discouraging European companies from relocating to such countries and importing back into the EU. The rationale is to prevent "carbon leakage", where companies might move to countries with laxer emissions standards. By doing so, the EU intends to protect its green sectors from unfair competition while simultaneously encouraging other nations to elevate their environmental standards (European Parliament, 2021).

It is evident from the above discussion that the EU has glanced at developments in China and the US and advocates a more active industrial policy and a more restrictive trade policy. The argument that political decisions should govern industrial production and choice of technology has been increasingly used. An alternative strategy for the EU could be based on improving the business environment through general measures but without hindering trade and foreign direct investment.

Improving the functioning of different markets would be positive for European competitiveness and growth. This could include aspects such as competition law, intellectual property rights and digital services legislation (Flam, 2021, p. 2.). In particular, competition should be strengthened as it is the basis for growth and development. Companies that rely on government support and protection from foreign competition tend to spend too little time developing their business. Large industrial investments also tend to favour large and already established companies and disadvantage small and midsize enterprises. This is a further argument that politics works against a dynamic business community.

One way to create the necessary pressure for change is to ensure that the internal market works as intended with full freedom for goods, capital, people and services to move across national borders. Signs of various restrictions on freedoms are beginning to emerge in the second half of the 2010s. For example, the migration crisis in 2015 led to the reintroduction of border controls within the EU, while the pandemic crisis led countries to introduce new travel restrictions and stop the export of goods that were considered particularly important, such as medicines and medical equipment. In the case of the trade freeze, countries seemed to learn from the cost of this type of policy and in the later stages of the pandemic trade flowed more normally, but the fact that a fundamental aspect of the free market could be compromised at all is a cause for concern. Work is now underway in the EU to prevent similar measures in future crises.

Another discussion in the EU focuses on trade in services. More specifically, work is underway to harmonize regulations around services markets, which would facilitate trade. Other areas would also benefit from more harmonization in order to deepen and improve integration and the functioning of the common market.

Making the single market work better is important. But it is also important to work towards a better functioning and more rules-based global economy. As noted above, the WTO is facing major problems and a number of different measures are likely needed if the world is to return to a rules-based trading system. It is in the EU's interest that this happens, which means that a thoughtful and coherent strategy from the Union is needed. The EU has historically been important to the global trading system and can hopefully play a leading role in addressing the major challenges that exist.

The problems cannot be solved with the existing rules; a major change is needed (Mavroidis & Sapir, 2021). Changing the WTO will not be an easy task, not only because of developments in recent years but also because the organization has grown to include more than 160 countries with different interests and preferences.

Multilateralism, joint commitments by all member countries, is an important part of the WTO guidelines. However, it is likely that a larger number of agreements with groups of member countries will be necessary. There is nothing to prevent such agreements as long as they do not adversely affect other members. Such work is already taking place in a number of areas. More specifically, in 2017, working groups were established between different countries focusing on reforms in various trade-related areas: e-commerce; trade in services; investment frameworks; and internationalization of small businesses (Hoekman & Sabel, 2021). Different countries are involved in the different working groups. For example, the EU and China are in all four groups while the US is only in one (e-commerce). The advantage of this approach is that it allows countries to cooperate in different areas rather than liberalizing all trade, as is the case in many other free trade agreements.

China's entry into the WTO has been problematic. The WTO's rules are not designed to deal with state capitalist systems like China's. Furthermore, the belief that China would change and become like any other market economy country has been proven wrong. On the contrary, China under Xi Jinping is moving towards less market economy and more of state control and governance. This was made clear at the 20th Party Congress of the Chinese Communist Party in Beijing in October 2022. The desire to increase self-sufficiency and reduce dependence on the outside world was clear, as was the emphasis on continuing to develop capacity for domestic innovation and technology.

Again, the WTO fails to address more unconventional protections for domestic industry. It seems necessary to address this shortcoming, in particular, to create an effective mechanism to prevent subsidies to domestic firms (Wu, 2018) and to counteract various types of "theft" of foreign technology (Branstetter, 2018). In their research, Mavroidis and Sapir (2021) show that both phenomena are particularly associated with China. Pressure has therefore increased since China's entry to create an effective WTO to tackle a new type of trade barrier (Payosova et al., 2018). The US trade war with China has shown that unilateral action is costly and rather ineffective, which is a lesson for the EU.

At the same time, one should be aware that it is not easy to change the regulatory framework in this direction. State-owned enterprises, where government subsidies are significant, are not covered by the WTO framework, which means that the role of these companies must be explicitly put on the table and included in the reform process (Ahn, 2021). Naturally, this is a development that China may well oppose. Furthermore, subsidies of various kinds are present not only in China but also in Japan, the US and the EU. These may be industrial subsidies, which are rapidly increasing in importance, not least in the EU, but also agricultural subsidies that are important in many countries. Removing these subsidies would improve global welfare, but this is politically very difficult to achieve (Evenett & Fritz, 2019). Increased imports resulting from the removal of subsidies will hit some groups hard and these groups will do what they can to politically secure their livelihoods.

When it comes to forced technology transfer, the problems are perhaps even greater. Many observers doubt that the WTO can deal with the issue (Mavroidis & Sapir, 2021).

Furthermore, a functioning dispute settlement mechanism needs to be put back in place. Over the years, around 600 trade disputes have been handled by the WTO, but as described above, the process has collapsed (see also Hoekman & Mavroidis, 2021). It is important that the US stops blocking this activity. It should be noted, however, that for this to happen, reforms of the WTO are required, roughly along the lines described above. The fact that the US is blocking the Dispute Settlement Body is, at least in part, due to the WTO's inability to handle different types of conflicts, and countries other than the US have also expressed dissatisfaction with the situation (Bown, 2019; Fiorini et al., 2019). Finally, even if new judges were appointed, the dispute settlement mechanism cannot be expected to play the same role as before. Many countries use trade barriers that violate WTO rules. This in turn means that these countries are likely to be wary of taking other countries to the WTO court. Otherwise, the accused countries are likely to respond with the same action (Evenett & Fritz, 2019). Again, this shows the complexity of the problem and a solution will require many different types of measures.

Remove Border Barriers for a Successful EU

Political attitudes towards globalization have changed in many parts of the world. From a positive to a more sceptical one. As a result, tariffs and trade barriers have increased. For the rest of the decade, the development of globalization will be determined by the evolution of political will and technological developments. New technologies, such as digitalization and AI, open up for trade in new products and industries, and these developments are largely beyond the control of politicians. Technological developments may therefore compensate for a lack of political will.

However, relying on technological progress is too defensive a strategy. The trend towards stronger internal and external borders that Johanna Pettersson Fürst highlights in her chapter in this volume is also evident in international trade. A continued trend towards less globalization makes the world poorer (Irwin, 2019), since less international specialization and less competition are negative for growth and welfare. The EU therefore needs to intensify its efforts to open both internal and external borders.

With regard to internal borders, a much greater focus is needed on improving the functioning of the internal market. Ensuring the free movement of people, capital and goods is the most important thing the EU can do to ensure future growth and prosperity. The tendencies towards new trade barriers that were evident during the pandemic should be pushed back. Similarly, proposals for an active industrial policy inspired by developments in China and the US are not the way forward. Selective selection and support of certain companies and industries by public authorities is a strategy that has been tried in many parts of the world. The negative experiences of such policies are well documented.

Ensuring the functioning of the internal market is important but not enough. The EU benefits from open global markets. Furthermore, as China and the US turn increasingly inward, the EU needs to step up and take greater responsibility for global trade liberalization. The challenge is great and requires a focused effort to both establish new trade agreements, particularly with the US and to revitalize the WTO.

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