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The EU Trade and Investment Policy: Navigating Challenges and Seizing Opportunities

The EU is facing increasing challenges in its trade and investment relations globally. How has the EU trade and investment policy adjusted to this new reality? Is the EU rightly seizing related opportunities for its own prosperity and competitiveness, the global economy and the rules-based multilateral trading system?

This short paper aims at shedding light on the challenging times we are confronted with, before delving into the new paradigm shift of the EU's trade and investment policy, and assessing its contribution to the EU and global trade and investment relations, as supported by the World Trade Organization (WTO).

Economic and trade challenges to the EU's prosperity and competitiveness

The EU's prosperity and competitiveness, traditionally founded to a great extent on open trade and investment, are profoundly challenged – on economic, security and geostrategic grounds – in a global economic and trade context marked by fundamental transitions.

The global economy is facing a historic level of protectionism and weaponised trade relations, which are leading to an emerging global trade and economic fragmentation, with an enhanced risk of escalation. The number of protectionist measures – covering goods, services, technologies and investments – has significantly increased recently, from 2,869 in 2017 to 6,000 in 2020 and reaching 4,493 in 2023 (Bouissou, 2024). In their geostrategic confrontation, the two largest global economies, China and the US, also have an increasing recourse towards beggar-thy-neighbour security-driven policies that render the EU and all economies globally more vulnerable. Furthermore, as explained in the World Trade Report 2023 (WTO, 2023), international trade is progressively shifting towards geopolitical lines; intra-bloc trade gradually becomes denser compared to inter-bloc trade.

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The consequences are already felt and may become dramatic for the EU, but also for the other global economic powers, and even more so for developing economies. A dislocation of the global economy would mean 7% to 12% GDP losses, reduced prosperity, soaring prices, slower growth, slower innovation, rising social risks and instability, increased risks of conflicts, and ultimately less economic security for the EU and on the global stage.

The global economic shift towards enhanced sustainability – greatly supported by the EU – is also going to entail more autonomous economic models that will rely differently and possibly less on international trade. By its essence, the circular economy, once mature, will fundamentally change our production and consumption model in creating further value based on existing, recycled products, which will entail different ways of trading. Even if driven by different factors (including circumventing tariff barriers), we may already observe a relocalisation (i.e. re- and near-shoring) of the production of batteries and wind turbines – clean tech that is key for the green transition – based on recent redirected investments, in support of the green transition.

The new paradigm shift of the EU's trade and investment policy

In this context, the EU aims at progressively adjusting and reinventing its economic and trade models. With the recent reorientation of its trade and investment policies towards open strategic autonomy, the EU is striking a very delicate balance, on the one hand seeking strategic autonomy – to the extent needed – which is aimed at enhancing resilience and competitiveness of the EU economy and related supply chains, as well as the protection of its fundamental economic interests through expanded autonomous trade measures. On the other hand, it is seeking further openness and cooperation with the broadest possible range of countries to the extent possible.

In other words, while the EU aims at minimising the vulnerabilities linked to growing economic security risks, it remains committed to preserving its traditional trade and economic openness and dynamism to the maximum extent possible. Most importantly, in a context of fundamental transitions, the EU's incrementally reoriented trade model is essentially aimed at contributing to a more resilient future – in the short and long run.

With its open strategic autonomy – progressively realised through the European economic security and de-risking strategy – the EU is not only aiming at effectively managing actual fragmenting trade relations, it is also importantly projecting itself into the longer-term future. We know that this more distant horizon will be an uprightly reformed rules-based multilateral trading system accompanying and supporting the trade and investment move towards re-globalisation, i.e. involving better and newly integrated economies globally, enhanced sustainability and growing services trade.

From this perspective, the EU should continue to leverage the core strengths of its normative model, i.e. it is open, rules-based, sustainability-driven, country-agnostic and has a limited security prism, to further assert its essential role on the global stage and thereby fundamentally contribute to a revamped, more harmonious global economy and trading system.

The EU trade and investment policy: From fragmentation to re-globalisation

Despite a more inward-looking approach, the European economic security strategy is still to a great extent embedded in rules-based openness for present and future times. It is founded on two main strategic autonomy pillars – proactive and defensive – both buttressed by a third one – on open dialogue and cooperation.

- The first pillar – the proactive perspective – is designed to promote the enhanced resilience and competitiveness of the EU's economy and its supply chains based on the EU's diversification (trade policy) and reinforced innovation and production capacities (industrial policy).
- The second pillar – the defensive approach – is aimed at protecting the EU from economic security risks based on existing, improved or new autonomous trade measures for a global level playing field, sustainability, sovereignty and security.
- The third transversal pillar – the cooperation perspective – is aimed at partnering with the broadest possible range of countries who share common economic security concerns or interests with the EU.

The EU's proactive approach: The EU's diversification strategy

On the proactive side, the magic trick for preserving to a maximum extent the EU's openness, in support of its resilience and competitiveness, relates to its diversification strategy, which extends to both the EU's external growth markets, and also, importantly, its sources of supply of key inputs for the green and digital transitions (e.g. critical raw materials, green goods). This new frontier of trade cooperation has translated into more diversified engagement, contributing thereby to progressive re-globalisation, as supported by rules-based multilateral trading – the very effective silent voice of continued agile international trade. It will benefit traditional trading partners, but also connecting countries such as near-shore destinations (especially, Central and Eastern Europe) or ASEAN nations, producers of raw materials worldwide, and emerging economic hubs (in manufacturing or services).

First, the EU's already wide network of free trade agreements (FTAs) is being adjusted and expanded to cover "new new" generation FTA provisions related to supply security. The latest examples include the EU-New Zealand FTA (which entered into force on 1 May 2024) and the EU-Chile FTA (soon to be ratified by Chile), which both comprise a detailed chapter on energy and raw materials, beyond the rules on trade and sustainable development. Even if the conclusion and ratification of EU FTAs has proven difficult in the recent past, the EU announced the conclusion of the EU-Mercosur FTA and the EU-Mexico FTA in previous weeks, which translates as a note of hope in protectionist times.

Secondly, complementary forms for cooperation have emerged. The EU has signed digital partnerships – covering supply chain monitoring through digital tools – with Japan, South Korea, Singapore and Canada over the 2022-2023 period. It has also concluded its very first digital trade agreement with Singapore in July 2024. Furthermore, the EU has established trade and technology councils with the US and India in 2021 and 2023, respectively. Their technical approach could be a strength for their continued operation and relevance, despite contrary winds. Partnerships on critical raw materials and industrial policy have also seen the light lately, for instance, the EU-Canada strategic partnership on raw materials, or the US-led minerals security partnership. Another interesting collaboration – the first of its kind – relates to the EU-Angola sustainable investment facilitation agreement (SIFA), signed by both parties in November 2023, which aims at attracting and expanding sustainable investments in all economic sectors of Angola, notably regarding raw materials and energy resources.

The EU's defensive approach: A paradoxically proactive EU regulatory framework

On the defensive side, the EU has expanded its legal arsenal of autonomous trade measures aimed at different essential objectives, including a global level playing field, enhanced sustainability, sovereignty and security. While it is designed to protect the EU's fundamental principles and interests, further conditioning the EU's trade relations and access to its single market, the EU's more inward-looking approach should also be assessed as a proactive

regulatory framework designed to incrementally lay the foundations of modernised multilateral trade rules and a reformed dispute settlement system as part of the WTO.

For instance, among the measures targeting a global level playing field, the EU foreign subsidy regulation, aimed at countering the distortive effects of foreign subsidies used with respect to economic activities in the EU internal market – in particular, those from China, is an essential instrument for the EU and other WTO members to pursue, at the multilateral level, competitive neutrality and the WTO fundamental principles based on the primacy of market forces and the convergence of economic systems. It may represent an interesting laboratory for developing a better knowledge base on subsidies and improved disciplines. Nevertheless, multilateral discussions are going to be harsh, given China's consistent opposition to modernised rules in this area, driven by its own emerging normative and governance model – socialism with Chinese characteristics – it aims to impose on the global stage.

Another relevant example concerns the EU's trade-related measures on sustainability, such as the carbon border adjustment mechanism (CBAM) or the EU regulation on deforestation-free products. While they may encounter opposing forces by trading partners and may need to be further aligned according to the adjustment capacity of the EU's trading partners, these autonomous measures are necessary to lead the way towards enhanced global sustainable trade, which is incrementally embraced by the rules-based multilateral trading system (e.g. the WTO agreement on fisheries subsidies – first agreement with environmental sustainability at its core; WTO discussions on environmentally sustainable plastics trade) and at the plurilateral level (e.g. The Coalition of Trade Ministers on Climate).

An interesting aspect to underline with the growing recourse of traditional rules-based trade defence measures by the three largest global economies, the EU, the US and China, is the parallel submission by the EU, but also by China, of related cases to the WTO dispute settlement system, which may serve to reinforce its core role as well as the effectiveness of its disciplines and thereby the WTO's continued legitimacy and credibility.

The EU autonomous trade measures based on sovereignty and security purposes may, however, be considered as more problematic with respect to the rules-based multilateral trading system. The EU anti-coercion regulation could be deemed WTO-inconsistent to the extent that it would entail the application of trade-related Union response measures without a prior decision from the WTO adjudicating bodies (Article 23 of the Dispute Settlement Understanding). Nevertheless, it is first conceived of as a deterrence measure – countermeasures are a last resort – and it foresees the continued possibility for engagement with the third country where relevant (Article 6 of the EU anti-coercion regulation).

The EU has also adopted a framework regulation for the screening of inbound foreign direct investment based on public order and security – one of the first new generation EU autonomous trade measures – in 2019, and it is currently assessing, together with the member states, whether an EU initiative is necessary regarding EU outbound investments in sensitive sectors, such as advanced semiconductors or artificial intelligence technologies, given potential security risks in the country of destination linked to their dual use nature.

The difficulty with measures based on national security is that they are generally adopted to last over time, and their scope may be progressively extended given their open, discretionary nature. The EU has, however, refrained from reading its trade and investment policy systematically through the prism of security. The EU autonomous trade or investment measures based on national security grounds are still very limited. Importantly, the EU economic security approach is essentially incremental, based on sound risk assessments. It involves constant coordination with the member states, as reflected by the process applied regarding a potential EU outbound investment initiative.

Conclusion

While the EU and the world are facing increasing challenges on fundamental economic, security and geostrategic grounds, the future of the EU and global economy is being built today, not only through the management of fragmenting economic and trade relations, but also in contributing to the incremental re-globalisation process and in laying the foundations for a reformed rules-based multilateral trading system in the longer term.

Based on its delicate balancing act between strategic autonomy and open dialogue and cooperation, the EU's reoriented trade and investment policy aims at positively integrating the challenging transitioning reality in relying – to the maximum extent possible – on the fundamental strengths of its model and bringing that in line with re-globalisation and a forward-looking WTO that has proven essential to global economic growth, innovation, investments, consumers preferences and global sustainable development.

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