Autonomy Versus Dependency: Why the EU Should Stick to the Idea of Open Trade

*
FILIP
BLAHA

The European Union's quest for more autonomy vis-à-vis the rest of the world (also called 'strategic autonomy') may come at the expense of serious sacrifices in the Eastern European countries. A closer look at the examples of the Czech Republic, Poland, Slovakia, and Hungary (the 'V4 countries') shows that the V4 countries are more vulnerable to policies aimed at reducing the EU's reliance on international trade. This is because these countries have a unique economic profile in contrast to other EU countries, and especially the founding members (France, Germany, Italy, and the Benelux countries). This difference is rooted in history, as after the collapse of the Soviet Union the Eastern European states adopted a laissez-faire approach to the economy to rapidly catch up to Western EU countries. Such an approach was their only option.

To come to this conclusion, an analysis capturing how vulnerable countries are to policies aimed at reducing reliance on international trade was calculated in this article. This analysis aggregates information about the ranking of countries in various macroeconomic indicators such as Gross Domestic Product per capita, *Human Development Index* (HDI), *the Foreign Direct Investments Restrictiveness Index*, Trade Openness, *Global Competitiveness Index* (GCI), and Foreign Direct Investments Inward flows. Overall, the analysis shows, apart from the Czech Republic, that V4 countries are more vulnerable to restrictive policies regarding international trade than other EU countries, especially the founding members.

These results are at odds with the general direction[1] the European Commission has pursued recently. It has introduced its 'strategic autonomy' agenda, which encompasses several policies related to the digitization and green transformation of the economy[2], with the goal of reducing reliance on international trade[3].

> ”
> AS AFTER THE COLLAPSE OF THE SOVIET UNION THE EASTERN EUROPEAN STATES ADOPTED A LAISSEZ-FAIRE APPROACH TO THE ECONOMY TO RAPIDLY CATCH UP TO WESTERN EU COUNTRIES

UNIQUE STRUCTURE OF V4 ECONOMIES WITHIN EU

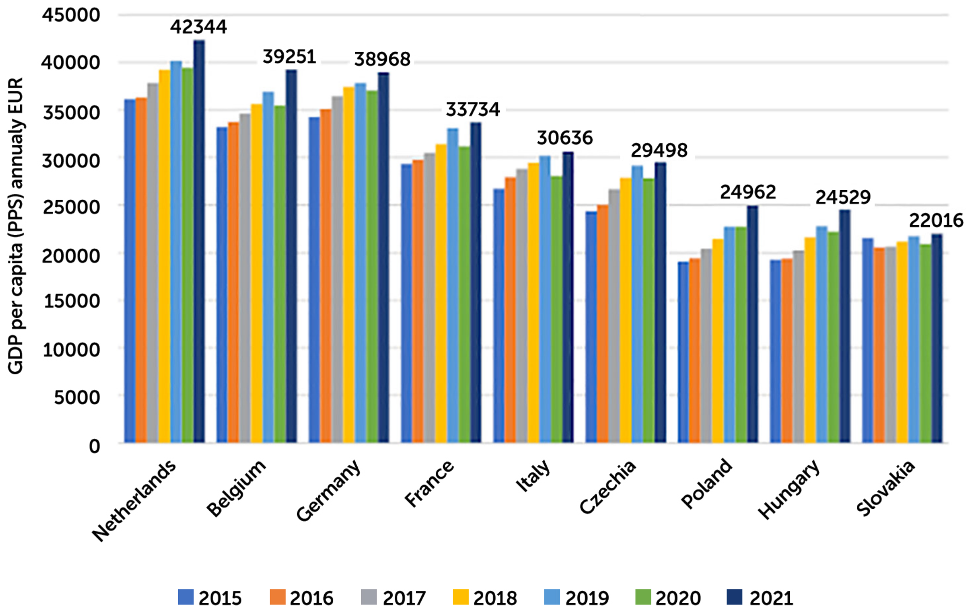
Together, the V4 countries are the fifth largest economy in Europe and 12th globally. The region would rank as the 22nd most populous country in the world and 4th in Europe (64 million people) with most people

[1] See, for example: Bauer, M. (2022) *The Costs of the EU's Strategic Autonomy Agenda – Why Member States Should Stop Ignoring Them.* Available [online]: https://ecipe.org/blog/eu-strategic-autonomy-agenda/

[2] See, for example: European Commission (2019) *The European Green Deal*, document COM(2019)640 final. Available [online]: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52019DC0640

[3] See, for example: Bauer, M. (2022) *The Costs of the EU's Strategic Autonomy Agenda – Why Member States Should Stop Ignoring Them.* Available [online]: https://ecipe.org/blog/eu-strategic-autonomy-agenda/

Figure 1: V4 countries' economies are still smaller than the western ones



Source: Eurostat (2022)

living in Poland (38 million), followed by the Czech Republic (11 million), Hungary (10 million), and Slovakia (5.5 million)[5].

However, as we can see in the following Figure, the V4 countries are still poorer than the founding members. Interestingly, Slovakia reports only 52% of gross domestic product (GDP) per capita in purchasing power standards (PPS) of the Netherlands in 2021. But while the Netherlands and other countries' GDP per capita have been rising in PPS terms, Slovakia's has held stable over the last seven years. This means that Slovakia has gotten relatively poorer with respect to all covered countries. In short, the V4 countries are still catching-up to richer EU countries.

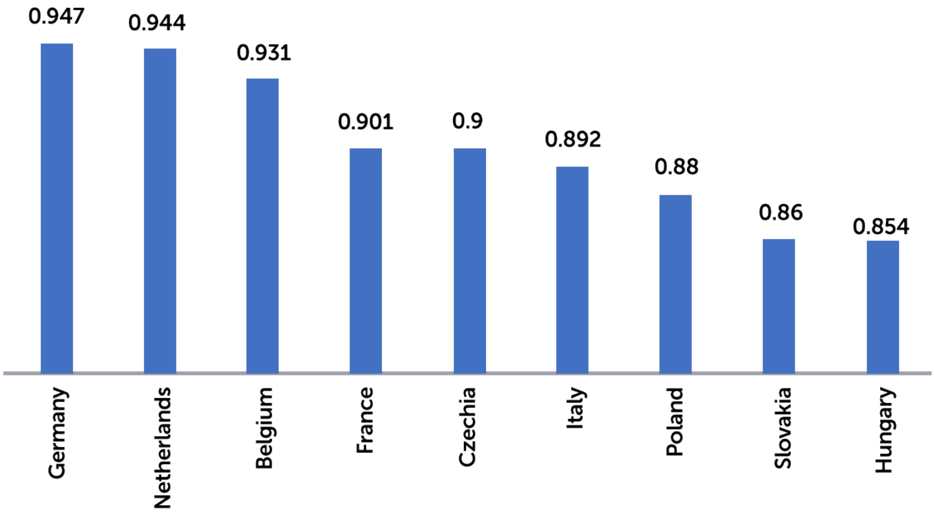
The V4 countries lag in terms of general development as captured by The *Human Development Index*. However, the Czech Republic stands out and is ahead of Italy [See: Figure 2]. V4 citizens have a lower quality of life with regards to criteria such as health, education, and economic level of the state than the citizens of founding EU members. However, considering the four countries' communist past, which for almost half a century damaged the institutional framework and hampered their economic development[6], a certain Western lead in this respect is understandable.

[4] Eurostat (2024) Purchasing Power Parities (PPPs), Price Level Indices and Real Expenditures for ESA 2010 Aggregates. Available [online]: https://ec.europa.eu/eurostat/databrowser/view/prc_ppp_ind/default/table?lang=en

[5] V4 Recharging Europe. See: https://v4.mfa.gov.hu/page/v4-facts-infographics-tbc

[6] Lipton, D.: "Eastern Europe", [in]: *EconLib*. Available [online]: https://www.econlib.org/library/Enc/Eastern-Europe.html

Figure 2: Quality of life, health and education is lower in the Eastern part of Europe



Source: UNDP (2019) Human Development Index (HDI)

Countries of the V4 are more industrial than the rest of the EU. The services sector appears to be less important, according to the level of imports of services. Imports of services are valuable sources of sharing new technologies and know-how. The gap between the levels of imports of the V4 and other countries demonstrates different opportunities and starting lines of innovations for the V4 and the Western countries [See: Figure 3].

According to the *Digital Economy and Society Index* (DESI)[7], which shows how countries use new technologies [See: Figure 4], the V4 countries lag in terms of usage of new technologies compared to the founding members. While Hungary, Slovakia, and Poland occupy positions at the tail end of this ranking, the Western countries all rank fifteenth or higher (among all EU members). The Czech Republic ranks nineteenth. Additionally, digitization shows an upward trend since 2017. This means that overall, connectivity, human capital, use of internet, and integration of digital technology and digital public services are developing in Europe.

”

THE V4 COUNTRIES LAG IN TERMS OF USAGE OF NEW TECHNOLOGIES COMPARED TO THE FOUNDING MEMBERS

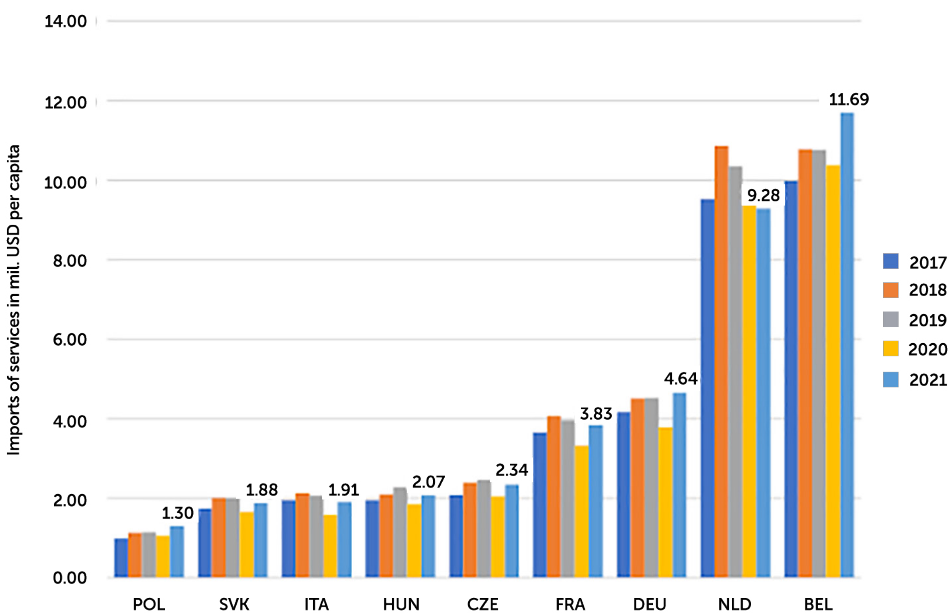
[7] European Commission (2022) *Digital Economy and Society Index* (DESI). Available [online]: https://digital-strategy.ec.europa.eu/cs/policies/desi

> LOW RESTRICTIONS AND LOW TAXES MADE THE V4 COUNTRIES MORE ATTRACTIVE TO FOREIGN INVESTORS AND INTERNATIONAL TRADE

V4 COUNTRIES' LAISSEZ-FAIRE APPROACH

The V4 countries have adopted a laissez-faire approach to be able to catch up rapidly to western EU countries, which, at the time, felt like the best solution to build a strong economy similar to other countries in Europe and securing the accession to the European Union. This trend is visible in the index capturing the level of trade restriction of an economy (the *Foreign Direct Investment* index) and the rates of effective corporate tax. Low restrictions and low taxes made the V4 countries more attractive to foreign investors and international trade. On the other hand, the EU founding members have shown a more restrictive environment [See: Table 2].

Figure 3: Eastern EU countries import in some cases up to five times less services than the Western ones



Source: OECD (2022)

The V4 countries (in compassion to EU's founding members) have so far not been active in screening foreign direct investments (FDIs) or regulating other foreign investments. This different approach to trade policy has provided the V4 countries with a comparative advantage in attracting investments compared to more developed founding member states[8].

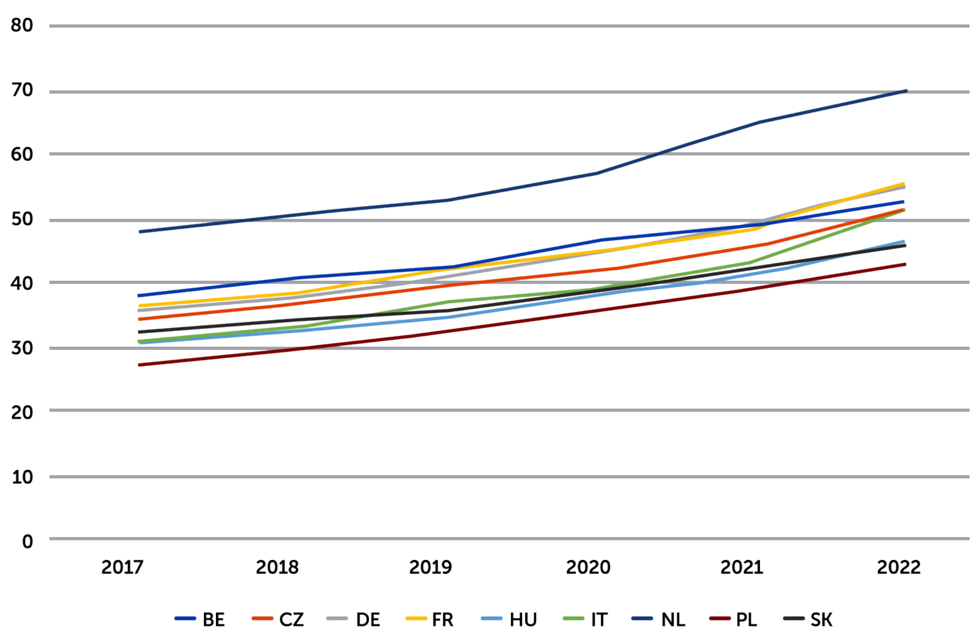
The level of corporate taxes in the V4 countries is generally lower, which might indicate a more attractive environment for business, including foreign direct investments [See: Table 3]. In this respect, a minimum global corporate tax rate of 15%, which was agreed at the OECD in March 2022[9] would take away this advantage of V4 states. This policy is also intended to help prevent profits being transferred offshore.

Even though the V4 countries try to attract FDI via lower effective tax rates, a new wave of protectionism – triggered by the EU-US trade war – has led to several measures restricting international trade. For example, in response to U.S. tariffs on steel and aluminum, the EU has imposed reciprocal measures on some 1,800 U.S. industrial, agricultural, and manufacturing prod-

[8] The index does not provide a clear dividing line between founding members and V4. However, considering the individual sectors, V4 indicates less restrictiveness policies.

[9] World Economic Forum (2024) *What Does the OECD Global Minimum Tax Mean for Global Cooperation?*. Available [online]: https://www.weforum.org/agenda/2024/02/oecd-minimum-tax-rate/

Figure 4: Digitization is supposed to lead the new age but so far it is only taking place in western EU countries



Source: European Commission (2022)

ucts worth EUR 2.8 billion of U.S. exports. After three years of continued US tariffs, these measures would then be extended to another 150+ products worth EUR 3.6 billion of U.S. exports[10]. The European Union implemented a new instrument in October 2020 to streamline the coordination of FDI screenings between member states. These efforts alone could have affected the rate of FDI flows. For the investors, however, they may also have appeared to be the beginning of new protectionist policies and have created a degree of uncertainty that may compound the negative effects[11].

[10] Harte, N. and E. Roderick. (2018) "US Tariffs: EU Response and Fears of a Trade War", [in]: *European Parliamentary Research Service*, PE 623.554, June 21.

[11] Gunnella, V. and L. Quaglietti (2019) "The Economic Implications of Rising Protectionism: A Euro Area and Global Perspective", [in]: *ECB Economic Bulletin*, Issue 3.

The V4 economies are more open to international trade [See: Figure 5] than the founding members: Italy, Germany, and France are almost twice less open to trade

”

ITALY, GERMANY, AND FRANCE ARE ALMOST TWICE LESS OPEN TO TRADE THAN V4 COUNTRIES

Table 2: V4 countries belong to the most open economies in Europe

	Total	Primary sector	Transport	Media	Telecoms	Finance	Business	Manufacturing	Electric, electronics and other instruments
Czech Republic	0.01	0.025	0.075	0	0	0.01	0	0	0
Slovak Republic	0.049	0	0.075	0	0	0.002	0	0	0
Poland	0.072	0.05	0.092	0	0.75	0.003	0	0	0
Hungary	0.029	0	0.167	0.298	0	0.005	0	0	0
Belgium	0,04	0.035	0.114	0.023	0.023	0.024	0,248	0.023	0.023
Netherlands	0.015	0.062	0.083	0	0	0.002	0	0	0
France	0.045	0.155	0.15	0.048	0	0.054	0,003	0	0
Italy	0.052	0.13	0.2	0.363	0	0.018	0	0	0
Germany	0.023	0.069	0.2	0.025	0	0.005	0	0	0

Source: OECD (2020) Foreign Direct Investments Restrictiveness Index

”

THE V4 COUNTRIES REMAIN ATTRACTIVE TO INVESTORS, IN PARTICULAR BECAUSE OF THEIR CHEAP BUT STILL RELATIVELY SKILLED LABOR FORCE, AND THEIR PROXIMITY TO LARGE EUROPEAN MARKETS

than V4 countries. Belgium and the Netherlands share similar levels of trade openness as the V4 countries. This could be driven by the high level of import and export in those countries, and the lack of industry. Policies aimed at relying less on international trade will tend to impact more the countries whose trade openness is higher.

The V4 countries rank lower in the Global Competitiveness Index (GCI) [See: Figure 6]. The only exception is the Czech Republic, which is catching up to Italy. The founding member states rank in the top twenty – or better. As Peragovics[12] concludes, the V4 countries remain attractive to investors, in particular because of their cheap but still relatively skilled labor force, and their proximity to large European markets.

Finally, the European Union adopting more restrictive trade measures may have led to lower levels of FDI in the V4. After the adoption of the trade measures in June 2018 against the United States at the EU-wide level, foreign investment inflows started to decline in the V4 countries [See: Figure 7]. Specifically, from 2018 to 2019, FDIs in the Czech Republic fell from USD 11 to 10 billion, in Poland from 16.3 to 13.3 billion, and in Hungary from 6.4 to 4.3 billion. This phenomenon may have been caused by regulatory actions on the EU level, but also compounded by the induced uncertainty in international trade that arose from restrictive measures. Such trade war measures can be considered as one of the uncertainty shocks, which forces companies

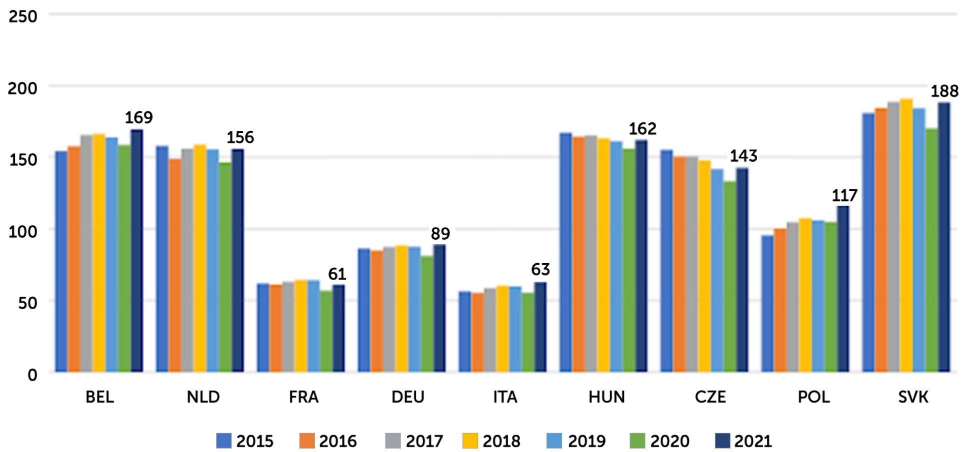
[12] Peragovics, T (2019) *Protection Without Protectionism? Foreign Investment Screening in Europe and the V4 Countries Today – A Comparative Analysis*, Centre for Economic and Regional Studies, May Working Paper No 252, pp. 1-31.

Table 3: V4 states use low tax rates

Country	Czech Republic	Slovak Republic	Hungary	Poland	Netherlands	Belgium	France	Germany	Italy
Effective forward tax rate	18.3%	19.3%	10.2%	15.5%	23.7%	20.3%	29.4%	28%	21.3%
Effective backward tax rate	17%	18.7%	11.1%	16.8%	22.5%	23.2%	28.1%	28.9%	23.9%

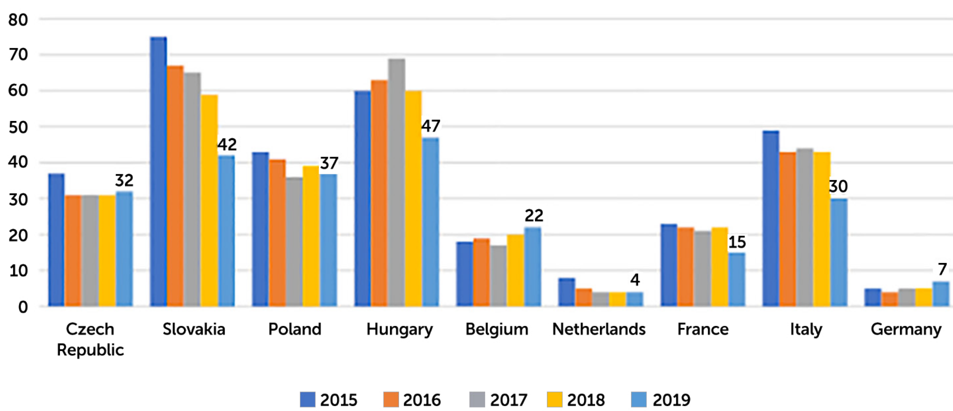
Source: OECD-Effective forward and backward corporate tax rate in the selected countries (2020)

Figure 5: V4 and Benelux countries rely heavily on foreign trade and are therefore vulnerable to policies reducing the reliance on international trade



Source: OECD (2021) Trade Openness

Figure 6: The economies of the founding countries are at the top of the global competitiveness ranking. All V4 countries are below them.



Source: World Economic Forum (2015 – 2019) Global Competitiveness Index (GCI) to reduce their foreign activities much more than their domestic ones [13].

From 2020 to 2021, Poland experienced a record increase in FDI inward flows, from USD 13.65 million to USD 26 million. According to government officials, Poland was able to benefit from the disruption of supply chains and the search for new alternatives in supply chain remediation, with the latter becoming one of the new alternatives for investors[14]. However, there is currently no research that analyses this fact in more detail.

In the case of Hungary, there is a large drop in FDI inward flows (from 7.9 million to -14.5 million USD from 2014 to 2015). This drop was caused by the long-standing bad Hungarian policy towards foreign investment, which included nationalizing companies or introducing sectoral taxes, but also by the country's poor fiscal and overall economic situation, as stated by the European Commission[15].

Similarly, the introduction of the screening mechanism might have contributed to the decline of FDI inflows in the Czech Republic between 2020 and 2021 from USD 9.4 billion to USD 5.8 billion[16]. In the case of Hungary, we can observe a decrease from USD 6.8 to USD 5.9 billion. However, given the effects of the COVID-19 pandemic, it is unlikely that the screening mechanism alone is responsible for the decline.

WHILE THE FOUNDING EU MEMBERS CAN WITHSTAND MORE ECONOMIC ADVERSITY THANKS TO THEIR HIGHER LEVELS OF WEALTH, THE POORER REGIONS AND COUNTRIES OF THE EUROPEAN UNION NEED ECONOMIC GROWTH

The effect of U.S. protectionism may have been relatively small for Europe as a whole, but it affected member states to varying degrees[17]. However, with the introduction of reciprocal measures and the further escalation of the trade war, the European Union has rather intensified the negative

[13] Novy, D. and A.M. Taylor (2014) "Trade and Uncertainty", [in]: *CEP Discussion Papers*, No 1266, Centre for Economic Performance, London School of Economics and Political Science.

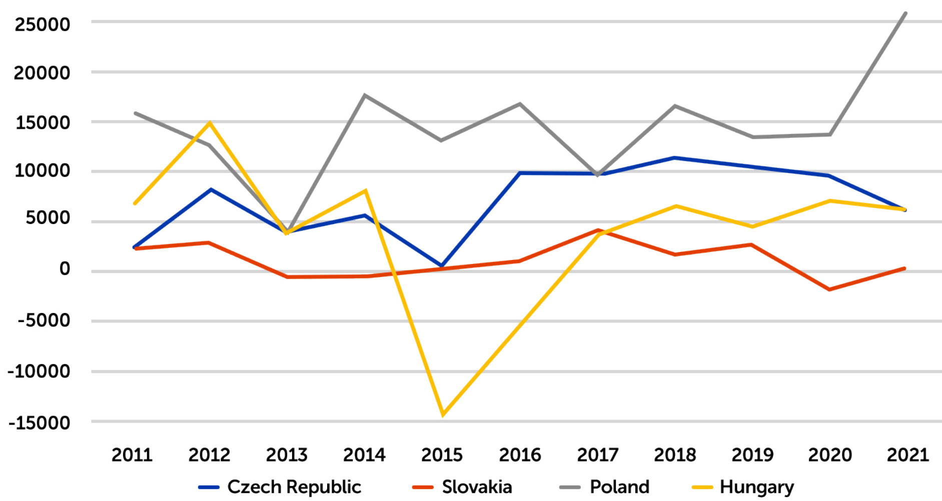
[14] Lyttle, C. (2022) "Poland Enjoys Record Year for FDI Attraction in 2021", [in]: *Investment Monitor*.

[15] European Commission (2015) *Macroeconomic Imbalances Country Report – Hungary 2015*, Directorate-General for Economic and Financial Affairs.

[16] This decline may come from the fact that additional screenings generate higher costs for the companies, which they try to avoid by choosing other destinations. The screening mechanism was introduced in 2021 by accordance with Act No. 34/2021 Coll. On screening of foreign investments. See: https://eur-lex.europa.eu/eli/reg/2019/452/oj

[17] Salotti, S., et.al. (2019) *Macroeconomic Effects of US Tariff on Steel and Aluminium: Who Would Pay the Bill*, EUR 29769 EN, Publications Office of the European Union, Luxembourg.

Figure 7: Declines in foreign direct investment inward flows may have been caused by EU protectionist policy



Source: OECD (2011–2021) Foreign Direct Investments Inward flows in millions USD

effects of the trade war[18]. In addition, the uncertainty stemming from fears of a new wave of protectionism that this situation may have triggered certainly played a role too and may have caused a postponement of trade operations by companies that feared rising protectionist policies[19].

EASTERN EUROPE IS MORE VULNERABLE TO TRADE RESTRICTIONS

To illustrate how vulnerable a country is to policies reducing the reliance on international trade, an analysis using macroeconomic indicators discussed was computed by the author of the article. The following discussion only focuses on the nine countries of interest, although the results can be generalized on the EU level.

According to the analysis, the V4 countries clearly lag behind the founding EU members [See: Figure 8]. The most significant difference can be observed for Slovakia, which scored only 44 points in 2019. Poland and Hungary achieved slightly higher scores with 84 and 67 points, respectively. The Czech Republic leads the V4 countries with 98 points, similarly to Italy and Belgium. The Netherlands, France, and Germany are in the top 10 with more than 120 points[20].

The founding EU member states benefit from generally higher socio-economic development levels (for example, GDP,

[18] Demertzis, M. and G. Fredriksson (2018) "The EU Response to US Trade Tariffs", [in]: *Intereconomics Review of European Economic Policy*, Vol. 53, No 5, pp. 260-268.

[19] Novy, D. and A.M. Taylor (2014) "Trade and Uncertainty", [in]: *CEP Discussion Papers,* No 1266, Centre for Economic Performance, London School of Economics and Political Science.

[20] See, for example: Bauer, M. (2022) The Costs of the EU's Strategic Autonomy Agenda – Why Member States Should Stop Ignoring Them. Available [online]: https://ecipe.org/blog/eu-strategic-autonomy-agenda/

”

GIVEN THE CURRENT GEOPOLITICAL SITUATION (THE RUSSIAN WAR IN UKRAINE, THREATS AROUND TAIWAN), EUROPE SHOULD RECONSIDER ITS DIGITAL SOVEREIGNTY AGENDA AND INSTEAD PURSUE GREATER REGULATORY CO-OPERATION WITH THE UNITED STATES

HDI, or FDI inward flows). In contrast, the V4 countries use their high openness and low tax incentives to attract foreign trade. As a result, the Czech Republic, which is among the most economically developed, has a similar position as Italy and Belgium [See: Figure 8].

V4 BENEFITS MORE FROM OPEN TRADE

While the founding EU members can withstand more economic adversity thanks to their higher levels of wealth, the poorer regions and countries of the European Union need economic growth. This is especially true because lackluster economic growth often leads countries to more authoritarian regimes that restrict citizens' liberties.[21]

There are three main areas in which policies are put forward that are aimed at reducing reliance on international trade: (1) the Green Deal, (2) Digitization, and (3) Strategic Resilience. In the case of the Green Deal, it is mainly about the energy mix. The fact that the V4 countries have been more dependent on Russian fossil fuels than founding members makes their strategic position worse off[22]. Therefore, the V4 needs the open market, open science, and open innovation to be able to switch rapidly from dependency on Russian fossil fuels, and not the EU's current focus on technological sovereignty, which might be in contradiction to the V4 countries' needs.

As for digitization, European regulators have taken aggressive action against U.S. technology companies for years, levying or threatening billions of euros in fines on Intel, Microsoft, Facebook, Google, Qualcomm, and Amazon[23]. Given the current geopo-

[21] Barchefsky, C. (2020) "EU Digital Protectionism Risks Damaging Ties with the US", [in]: Financial Times. Available [online]: https://www.ft.com/content/9edea4f5-5f34-4e17-89cd- f9b9ba698103

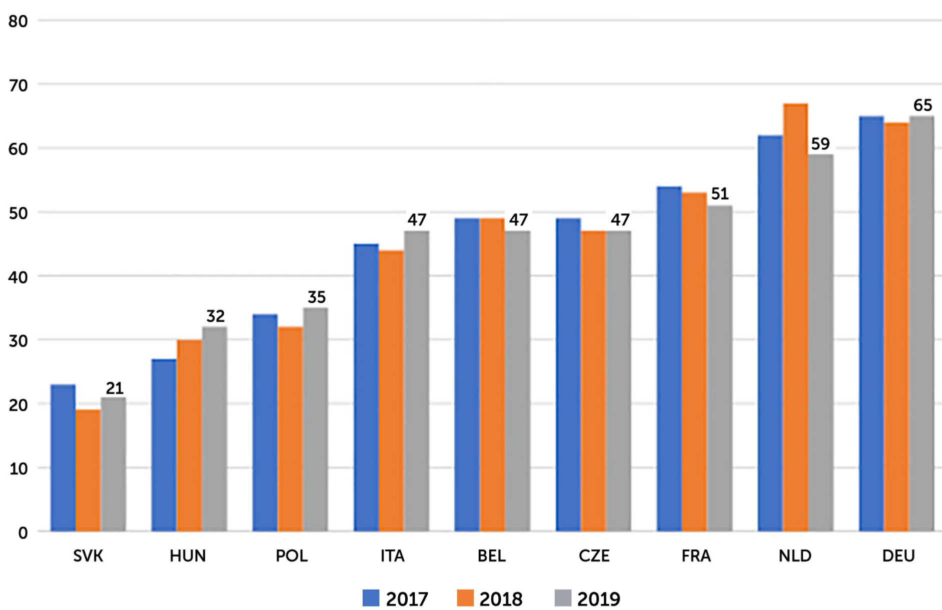
[22] See, for example: Bauer, M. (2022) *The Costs of the EU's Strategic Autonomy Agenda – Why Member States Should Stop Ignoring Them.* Available [online]: https://ecipe.org/blog/eu-strategic-autonomy-agenda/

[23] Barchefsky, C. (2020) "EU Digital Protectionism Risks Damaging Ties with the US", [in]: Financial Times. Available [online]: https://www.ft.com/content/9edea4f5-5f34-4e17-89cd- f9b9ba698103

> ANY PROTECTIONISM MEASURE CAN AFFECT THE FINAL CONSUMER IN EU COUNTRIES, ESPECIALLY IN THE DIGITAL ERA

litical situation (the Russian war in Ukraine, threats around Taiwan), Europe should reconsider its digital sovereignty agenda and instead pursue greater regulatory co-operation with the United States. Additionally, as Barchefsky adds, "*Demoni[z]ing US technology companies hinders efforts to address the foremost challenge for both sides with respect to the digital economy: China. Chinese protectionism (...) poses an existential threat to a vibrant digital economy. For example, China is pressing for a new centrally controlled internet, which the US and EU oppose*".

Figure 8: Germany is the least vulnerable to protectionist policies (data from 2019)



Source: Own elaboration based on data of Gross Domestic Product per capita, Human Development Index (HDI), the Foreign Direct Investments Restrictiveness Index, Trade Openness, Global Competitiveness Index (GCI), and Foreign Direct Investments Inward flows

CONCLUSIONS

Reducing the reliance on international trade could generate higher costs for the V4 countries than for the founding members of the European Union. This is particularly important as the European Commission is pushing for major policies under its strategic autonomy agenda, whose exact purpose is to reduce reliance on international trade.

As Gunnela[24] claims, there are several channels by which economic activity might be affected by policies aimed at strategic autonomy. Significantly, higher custom duties lead to higher prices for final imported products or services. Usually, the increased monetary amount of the product or service depends on the substitution effect for the affected goods. However, in the case of IT services, EU countries have low chances to substitute high-tech products and services in the short term (for example, the operating systems or highly developed cloud systems from American-based companies). Therefore, any protectionism measure can affect the final consumer in EU countries, especially in the digital era, when these IT services are used on a daily basis by the majority of the population in each country.

Further research is needed to exactly understand the costs and benefits of these policies in individual countries and figure out the 'losers' and the 'winners' of the EU's strategic autonomy. The European Union should return to its original idea of creating free trade, not trying to prevent it. Moreover, as has been demonstrated, this hindrance may have more negative effects for the Eastern European countries and, therefore, it should not only take into account the macro aspect but also the local economic specifics of all member states.

[24] Gunnella, V. and L. Quaglietti (2019) "The Economic Implications of Rising Protectionism: A Euro Area and Global Perspective", [in]: ECB Economic Bulletin, Issue 3.

*

FILIP
BLAHA

Analyst at the CETA - Centre for Economic and Market Analysis in Prague, the Czech Republic, and the Chairman of the Czech Students for Liberty