# Deglobalisation Essay Series 1

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# Open Strategic Autonomy:

## The European Approach for Stable Supply Chains[1]

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Globalization has led to an unprecedented growth of international trade and prosperity. Reduced transport and communication costs and reduced trade barriers have led to the development of complex value chains. An increased competition, additional specialization, and more differentiated division of labour resulted in higher prosperity in many countries, especially in those that have integrated into world markets thirty years ago. Former communist countries and China have opened their economies to international competition and have increased their growth. For many years, global trade has grown faster than GDP, indicating an ongoing integration of the global economy, but this process has now come to a stop. Additional developments and risks

[1] See Bardt et al. (2022) for more detailed reflections, including the implications for semiconductor subsidies.

within global supply chains have raised concerns about a process of deglobalisation:

- The dependence on natural resources from specific countries has been discussed for 15 years, especially since China has a market share of more than 95% in supply of rare earth elements. Geological factors as well as extreme costs of additional production can lead to stable de-facto monopolies.

- Growing protectionism and various nontariff trade barriers (Yalcin et al., 2017) as well as increasingly important distortions of competition due to Chinese state capitalism (Bardt & Matthes, 2021) pose additional risks to an internationally optimized division of labour.

- Technological dependencies can arise when traditional competitive advantages disappear. While loss of competitiveness imposes a threat to a country's wealth, dependencies imply the potential to be exploited or cut off from necessary technologies.

- COVID-19 has led to massive and long-lasting frictions in international supply chains. Lockdowns, production stops, lack of logistical capacity, fluctuating demand, or closed borders have interrupted production along the value chains (Grömling et al., 2021; Bardt & Grömling, 2022).

- The Russian assault on Ukraine has shown the vulnerability of supply chains. Although Russian and Ukrainian non-energy exports are only responsible for about 1% of German imports, production in Europe has been affected by the lack of supplies. Hence, a sudden stop of energy and especially natural-gas imports from Russia has a more dramatic economic effect.

Although it is the companies' responsibility to organize stable supply chains, there are reasons to address these questions on a political level. One of them is an economic argument: high risks due to dependencies of individual companies could be clustered in certain procurement regions. Randomly distributed cases of damage in a few companies due to economic dependencies would have a smaller effect than if a large number of value chains were affected at the same time. If many companies and value chains are affected, this could lead to significant macroeconomic losses. Therefore, policymakers tend not to leave responsibility at firms' management only in such cases. The other reason is a political one: economic dependencies can lead to political dependencies. The European need for Russian gas supplies is a prominent example, as the potentially huge losses of a natural-gas embargo makes political decisions more difficult. Restrained political communication towards China can also be motivated by not endangering important economic relations. Policymakers do not want to be inadequately restricted in foreign policy by economic interests. Reducing economic dependencies could, therefore, increase political degrees of freedom; although interdependencies can increase stability, as all partners have to accept the other one's perspectives.

The European Union has proposed the concept of open strategic autonomy to address the risks of political and economic dependencies. In a study by the European Parliamentary Research Service, strategic autonomy is defined "as the ability to act autonomously as well as to choose when, in which area, and if, to act with like-minded partners" (Anghel et al., 2020, p. 3). It is also stressed that strategic autonomy “is not about self-sufficiency but about means and tools to reduce external dependencies in areas deemed strategic and where dependencies could compromise autonomy, whilst continuing to cooperate with partners in a multilateral setting.” Strategic autonomy, therefore, is placed somewhere between the extreme points of dependency and autarky. However, the idea of maintaining the ability to act politically and economically independent through avoiding strict dependencies while not seeking self-sufficient isolation or autarky is not helpful to guide economic policy. It does not provide orientation on how much independence should be aimed at, what instruments should be implemented, and how it can be ensured that there is no tendency towards intervention and isolation. Market-based international division of labour and international trade are fundamental factors of prosperity. The general definition of strategic autonomy does not address the trade-off between gains of wealth due to international trade and potentially dangerous dependencies. It also does not address the option of interdependencies, which are more stable and less risky than one-sided dependencies.

The idea of strategic autonomy is to reduce dependencies in areas that are defined as “strategic,” or where dependency could reduce autonomy. However, in a market economy, there is no good that can be characterized as strategic per se. The European Commission has tried to identify strategic dependencies to lay the ground for political activities to reduce these dependencies (European Commission, 2021). To be qualified as one of the most dependent products, a good must be characterized by (1) high concentration of import sources, (2) high share of imports in total demand, and (3) a high quota of extra imports to exports. The first criterion should measure a huge share of European imports compared to the world market; therefore, switching to alternative sources might be difficult. The second indicator is about the relevance of imports for internal consumption (what is discussed as dependency in the case of natural gas). The third indicator measures the European ability to use domestic production if exports shrink due to reduced imports. The strategic nature, however, should, according to the European Commission, “be assessed on a case-by-case basis, relying on in-depth discussions with Member states and relevant industries” (European Commission, 2021, p. 23). There is no fixed set of criteria to decide whether a product is strategic or not. However, far-reaching implications on other value chains (the EU is using the concept of ecosystems) seem to be an important qualifier for the standard of being “strategic.”

Among the products identified by the European Commission are raw and processed materials and chemicals for energy-intensive industries, health-related products, and goods related to electronics, digitization, and renewable energies. This is not surprising, as the dependence on natural resources from certain countries has been discussed for years, and basic materials are essential for the different and complex value chains in Europe. Other product groups like medical equipment, green and digital products reflect the needs of the COVID-19 experience and the disruptive trends the European economies and societies are facing. State-of-the-art knowledge and competitive advantages in these technologies will have a significant positive impact on future prosperity—or a lack of competitiveness would endanger Europe’s economic and political strength and, therefore, be of significant (or strategic) political relevance.

While the value of technological competences and secure supply chains is obvious, it is more difficult to assess if managing (or reducing) dependencies is the companies' responsibility or if political action is needed. Simply claiming that certain products are "strategic" is not enough, as the decision becomes arbitrary without clear criteria. In contrast, political interventions in market processes need specific justifications. Economic theories provide various arguments for "market failure" that should be considered in this discussion.

However, the primary responsibility for security of their supply lies with the companies. They must weigh the costs of additional security measures and costs and the probability of potential cases of supply-chain disruptions. Disruption of supply, while costly, does not constitute a market failure that would require governmental intervention. Three main reasons for governmental intervention beyond the arbitrary attribution of a strategic character or the unprecise definition of autonomy may be relevant:

- Decentralized coordination can fail if too many companies rely on the same strategy in case of an emergency. If one provider fails and all customers try to switch to other providers, capacities can be exhausted quickly here as well. Secure supply would then not be possible despite the decentralized hedging strategies.

- Certain technologies can produce significant spillovers or positive externalities, but the lack of basic goods can also lead to huge negative spillovers. If one market player fails to deliver or is driven out of the market (maybe as part of a governments attempt to increase political pressure), and that situation would produce massive cost effects for many other companies in the affected value chains, government interventions (like regulation of these companies or investment in knowledge creation to reduce bottlenecks) can become necessary.

- Other cases of dependencies are relevant for the provision of traditional public goods. Public health, for example, requires certain equipment that must be purchased by public authorities (if they are responsible for providing of health services) but not necessarily be produced domestically.

Governments are not, and should not be, responsible for managing all potential supply risks that may be hidden in global value chains. However, dependencies that are combined with significant external effects of supply interruptions can have a huge economic effect that cannot be ignored by policymakers. However, it is not sufficient to label a product as "strategic." Several mechanisms related to "market failure" cases can give orientation whether governments should intervene or not. Interfering too often would reduce the incentive for companies to manage risks properly; reacting too late would create unnecessary costs. Some of the underlying risks are basically political risks, which are more difficult for companies to cope with. Reducing these risks and providing assistance in case of politically induced crises would also be part of the necessary public-risk management.

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