

## Rising Protectionism within the Global Economy

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### Abstract

*After more than two centuries during which economists have pointed to the benefits of free trade, compared to the costs of applying trade restrictions, one of the most significant events marking the beginning of the 21st century is the transition from globalization and trade integration to nationalism and protectionism. The International Monetary Fund warns that protectionism is increasing and poses a threat to global economic growth. Uncertainty related to protectionism is pressing for the economic outlook situation and could erode and further affect the euro area and the global economy. The present article discusses why rising protectionism re-emerged in the global economic arena, identifies a set of economic and socio-political determinants and brings to the forefront possible macroeconomic implications of an escalation in trade tensions. We propose to tackle current movements such as Brexit and Euroskepticism that challenge the principles of trade liberalization, generating an increase in sovereign national accents.*

**Key words:** globalization, protectionism, trade liberalization, global economic growth, trade integration

**J.E.L. classification:** F02, F13

### 1. Introduction

The post-crisis constant weakening of global trade, in an obvious contrasting situation with the market acceleration in the previous two decades, has been one of the most debated topic within discussions that concerned the current global policy. Given the importance of trade in generating innovation, lifting productivity and ultimately encouraging economic growth, a deep understanding of trade developments and outlook is crucial for policymakers.

One of the most significant events marking the beginning of the 21st century is the transition from globalization and trade integration to nationalism and protectionism. The International Monetary Fund, through the voice of the director of the institution, warns that governments should avoid protectionism in all its forms, citing history, which shows that import restrictions affect all global players, especially poorer consumers. "Not only do they lead to more expensive products and more limited choices, but they also prevent trade from playing its essential role in boosting productivity and spreading new technologies." (Lagarde, 2018, Speech at University of Hong Kong).

Recent research conducted around the topic of reconfiguring the global economic order revealed three possible perspectives under which global economy can be deciphered, in the context of moving from a multilateral system, organized around one great power to a multipolar one, dominated by bilateral and regional arrangements (Bucătar, 2018, p.107). The relevant perspective, identified and explained previously, for the topic of this article is the one referring to a possible future collapse of the multilateral trading system generated by the Republican administration installed in the United States (US), in 2017, considered protectionist and nationalist which already took important actions with obvious intentions to replace multilateralism with bilateral negotiations. The denunciation of the Transpacific Commercial Agreement (TPP), the attitude towards the North

American Free Trade Agreement (NAFTA) and the Transatlantic Trade and Investment Partnership (TTIP) along with intense discussions on tariff barriers as protection of some economic sectors, US firms urged to move home, repatriating profits, expressing doubts about new international financial system regulations, and so on denotes a radical change of vision in external trade relations - if we relate it to post-1945 dominant thinking.

As free trade has been openly called into question in the US, public support for globalization has declined on both sides of the Atlantic. Factors such as Brexit and Euroskepticism have challenged the principles of freedom of movement and economic integration in Europe, the European Union's countries showing an increase in sovereign national accents. But the EU rules still maintain the free trade order. Many European leaders are worried about the approach taken by the new Republican administration and Brexit can be judged in the logic of changes in the US, even though the United Kingdom (UK) remains attached to the vision of free markets.

In the case of the BRIC states, a strong rising protectionism at a global scale will affect mostly China that has abandoned protectionism and adopted an expansionary fiscal policy, but if the crisis expands and leads to persistent social movements, the Communist Party will clearly be pressured to adopt a tough line both to suppress dissent and rethink its open trade strategy and other measures of economic liberalization. Brazil has a more conservative financial system and is less influenced by international trade, while Russia is more affected by the price of oil than by the volume of industrial exports. Despite declining exports, India is less exposed financially, but there could be a crisis response at the level of various separatist movements in India, leading to external instability, less likely related to protectionism.

After putting things in perspective by creating an imaginary map of protectionism manifestation around the globe, several questions may arise: is trade protectionism re-emerging as a controversial tactic among policymakers and economists in enhancing a nation's economic well-being? Could trade protectionism generate a crisis like the one of the 1930s? The article discusses why rising protectionism re-emerged in the global economic arena and what are the macroeconomic implications of this fact, answering, to some extent, this questions and identifying the determinants of new protectionism of the 21<sup>st</sup> century. In order to understand protectionism, it is necessary to know how it manifested itself throughout history. For this, we entered in history and contextualize the phenomena subjected to our analysis, with the intention to interpret and to understand the current global economic situation, the following findings having no normative character.

## **2. Theoretical background**

For more than two centuries, economists have pointed to the benefits of free trade, compared to the costs of applying trade restrictions. Adam Smith, in his famous work, *The Wealth of Nations* (1776) laid the foundations for the free exchange institution with a force of persuasion that kept its intensity in time. Smith pleads for the system of natural freedom, in which the individual is free to pursue his own interest, while the state has only the role of providing the legal framework for conducting the economic activity. "Free exchange made without restrictions and with regularity is always advantageous, although not equally advantageous for both parties "(Smith, 1962, p. 327). We can say that Adam Smith demonstrates that tariff barriers and non-tariff barriers hamper the free competition and freedom of action, freedom that is the engine of economic development.

David Ricardo enters the direction opened by Smith, pointing out that perfect trade freedom spreads general advantage and strengthens the universal society of nations. He proposes a gradual return to the "sound principles of free trade" (Ricardo, 1959, p. 236). The principle of competitive advantage states that it is appropriate for a country to specialize itself in the production and export of those goods that provide it with the highest efficiency. In Ricardo's view, the "pattern" of international trade is not outlined by the absolute cost of production, as Smith thinks, but by the opportunity costs. For example, a country is efficient in producing two goods, A and B, and in producing B, it is more efficient than other countries; so it is more advantageous to export good B and import good A. The principle of competitive advantage remains the cornerstone on which the entire theory of international trade has been consolidated and inspired many other economists concerned with international trade issues.

John Stuart Mill analyzes in more detail the gains associated with foreign trade, highlighting the existence of direct economic benefits, indirect benefits and benefits of moral and intellectual inference. Mill believes that expanding the marketplace beyond national boundaries leads to a more rigorous division of labor, an intensive use of machinery, and hence to the interventions and improvements in the production process. Another indirect advantage is given by the fact that opening up to the outside, through trade, sometimes can become a sort of industrial revolution. Trade facilitates the access of the people of a country to new commodities that they previously did not know or could not afford. Thus, people are motivated to work harder to meet their new wishes and are even tempted to save and accumulate capital to provide more satisfaction in the future. Mill emphasized that the economic benefits of free trade are outweighed by the moral and intellectual ones. If, many centuries ago, it was the war that, beyond the sides and the negative effects, connected people who belonged to different worlds and cultures, today this role belongs to the trade. Thus, trade becomes one of the main sources of progress. At the same time, Mill also assigns it the role of educator, as it teaches nations to look favorably on the well-being and prosperity of other nations because a rich nation is a potential commercial partner solvable for other nations. The rapid expansion of international trade becomes, in the opinion of the same author, a guarantee not only for world peace but also for the continuous progress of ideas, institutions and the character of the human race.

If the three liberal classics, Smith, Ricardo and Mill, build their theories based on a series of common hypotheses, being convinced of the virtues of free trade, P. Samuelson points out the existence of limits, launching the idea that when economies face dysfunctions it is difficult to determine if countries will benefit from trade or not. According to Kicsi R., history has shown that this theory has fewer followers in times when economic activity is disorganized; for example, during the crisis of the 1930s, the nations have raised real "tariff kits" in an attempt to recover (Kicsi, 2013, p.26).

More or less visible protectionist measures have become a reality of the contemporary world in which all countries want to limit their imports and, at the same time, amplify their exports, situation characterized by L. von Mises as grotesque, stating that "the only great achievement of protectionist tariffs is that it prevents production from developing where natural and social conditions are most favorable" (von Mises, 2002, p. 130,136).

Milton Friedman is also convinced that "free trade not only contributes to world welfare, but also fosters peace and harmony among nations." However, even if economists continue to deliver strong arguments in favor of international trade, protectionist measures are booming in many highly industrialized countries.

On the other hand, one the most popular supporters of protectionism measures is the Nobel Prize winner Paul Krugman that referred to the "Noble lie" that the depression of the 1930s was caused by protectionism, arguing that that crisis was generated by deflationary macro-politics and that the exit from the current crisis can be done through tax incentives. Starting from the hypothesis launched by Jonathan D. Ostry, Deputy Director, International Monetary Fund, according to which "It is sometimes alleged that for all the microeconomic distortions that protectionist policies inflict, there can be a silver lining in terms of macroeconomic gains: more jobs, more output and a stronger trade balance" (Ostry, 2019), we could motivate why, indeed, some economies today are apparently using commercial policy to pursue macroeconomic objectives. "Tariffs can dampen imports, boost net exports (the difference between exports and imports, or the trade balance), and so boost GDP, other things being equal" (Ostry, 2019).

### **3. Research methodology**

Connected with previous research concerning the economic impact of globalization, the present paper is an analytical one which puts rising protectionism in perspective by investigating current data collected from specialized bodies like the World Trade Organization (WTO), the Organisation for Economic Co-operation and Development (OECD), the United Nations Conference on Trade and Development (UNCTD), Global Trade Alert (GTA) and also recent ideas launched by important experts from institutions that play key roles in setting global economic policies, such as the International Monetary Fund or the European Commission. In addition, opinions of economists

that marked the history of the economic science were analyzed, in order to create a solid theoretical base for our investigation.

We also want to emphasize the interdisciplinary character of our paper due to the investigated aspects that fit mainly in the economic sphere, but have important and relevant connections with other fields like political sciences or international relations.

The research methodology used in the paper included several stages: documentation and information (including consultation of representative works in the field), synthesis and systematization, and finally, a personal approach on the complexity of the phenomenon regarding the protectionist pressure within the global economy, mainly its influence on international trade.

Given the complexity of the topic, the present paper aims, first of all, to highlight the dynamics and peculiarities of the evolution of trade protectionism after the economic crisis, through a review of its the main determinants. Secondly, it outlines the global implications of the protectionist phenomenon from two different perspectives for a better understanding of the topic. The analysis is based on historical facts and current results of the latest WTO-OECD-UNCTAD monitoring reports and also on the findings of an independent monitoring initiative.

#### 4. Findings

The process of trade integration started after the Second World War. It gained new impetus in the 1980s and had a golden age in the period 1990-2008, when total trade in goods and services increased from 39% to 61% of world GDP, proving to be an essential factor in economic growth and development that has benefited many countries in the world. At present, international trade is going through a very difficult period, with a current ratio of 58% of world GDP, marked by the increase in restrictions on goods and services flows and the implied tensions in trade relations between states of the world, accentuating hostile perceptions of trade and collaboration in the commercial sphere.(The World Bank, 2018)

The fact that the dynamics of international trade has registered a downward trend in recent years, and foreign direct investments flows (FDIs) have not yet managed to return to the pre-crisis level, generate major challenges for the global economy, especially since recent analyzes suggest that, at present, trade is no longer a driver of economic growth, neither in industrialized countries nor in emerging countries (Hoekman, 2015). In the context of these new realities outlined in the global commercial landscape an aggravating factor that makes its presence more and more pregnant is, without a doubt, rising protectionist within the trade policy measures.

At a global scale, opinions on the intensity, dynamics and the potential impact of current protectionism is divergent, which is explained, partially, by the significant differences between the results of several monitoring exercises, and in particular between the reports prepared by the two major monitoring bodies - WTO and GTA. While the WTO assessments reflect an indulgent and rather optimistic note, those of the GTAs are much more intransigent and even alarmist, which is why the role of the latter was assimilated to that of an "aggressive guard dog".

According to a research conducted by David Lowe, head of international trade at law firm Gowling WLG, using World Bank, Heritage index and Global Trade Alert figures, in 2017, quoted by Reuters Press Agency in London, the world's top 60 economies have adopted more than 7,000 protectionist trade measures since the financial crisis and tariffs are now worth more than \$400 billion. The US and EU were each responsible for more than 1,000 of restrictions. India was next with over 400 followed by Argentina, Russia and Japan all with restrictions between 365 and 275, while only three countries - Brazil, Saudi Arabia and Tunisia - had liberalized trade rules over the period (Reuters, 2017).

##### *Determinants of new protectionism of the 21<sup>st</sup> century*

Changes in the international context have led to two major consequences on trade policy: 1. companies have realized that the comparative advantage has gained a volatile character and seeks to ensure that their rivals do not engage in what they consider to be incorrect trade; they try to press governments and international institutions to harmonize policies so that all competitors work in the same framework; 2. The accentuation of international instability is accompanied by an increase in the feeling of insecurity of workers, the problem of job insecurity concerning both skilled and

unskilled work; the possibility for companies to reorient themselves to other locations generates pressure from workers to introduce a regulated framework to defend their rights. In consequence, when identifying the processes and facts that explain why rising protectionism re-emerged in the global economic arena we divide them into two categories: 1. economic evolutions; 2. dangers to the security of citizens, states.

Concerning the first category we have distinguished the following factors:

- Erosion of the US position in the distribution of economic power in the global space. For the first time in the last centuries the economic preeminence of the Western world is threatened by the rise of Asia, China in particular, but also of India, determining a multipolarization of the global economy. A consequence of this fact is that arrangements like Bretton Woods compete with alternative agreements and institutions, mainly promoted by China, to which many European countries have joined.

- New technologies (the Fourth Industrial Revolution) eliminate labor intensively, but economic and public policies are responsible for social dislocation. Imposing barriers to accessing foreign goods on markets in countries such as US, UK, France or other several countries is directly linked with massive job losses in the manufacturing industry of trade-deficient states. China, South Korea, Malaysia and several other Asian countries have followed export-led growth policies.

- Bad corporate practices, avoidance of taxes and fees (including export earnings), hostilities of public authorities, fueling reactions against globalization. The "new globalism" that only serves the business interests of corporations, causing subordination of workers, consumers, public and social interests and even of profit, considered one of the biggest changes in the world in the last 350 years, imminently generates protectionist reactions.

- There is a widespread feeling that external (financial) markets exercise excessive power in influencing national government decisions. In this respect the problem is delicate because the legitimacy of those with mandate to manage public affairs is at stake. The most eloquent situation is that of the EU within which it is manifested an institutional crisis. Nowadays, many nationalist parties reject the need of supranational institutions and claim that EU membership undermines national sovereignty and freedom. This led to the 2016 referendum in the UK. The Brexit's evolution, the inability to reach an agreement, and the contesting of this process give reasonable arguments to sustain the existence of a strong link between nationalism and the lack of a future-oriented vision, which means consequently the incapacity to deal with nowadays issues: climate change, migration, technological disruption, bioengineering matters, that cannot be managed by the State only, as it lacks the resources and capacities. Brexit and the current US Administration have opened a new door to undemocratic populist movements in Central and Balkan Europe. More and more frequently, some European leaders reject the idea of liberal democracy, promoting populism dressed in a non-developed regional nationalism, oriented to structural and institutional changes in Europe. In the context of mistrust in supranational institutions and national parliaments, there is an attempt to build a new type of decision-making system based on nationalistic and economic arguments specific for a neoliberal market, that nevertheless does not lack a significant Euroskepticism mark.

Moving on to the second category proposed in this article, we bring to the forefront the fact that increasingly prominent on the public agenda in Western countries is the issue of safety, protection of citizens and the state as a defender of public interests. The US has been hit by terrorist attacks in September 2001, which changed the concept of security of citizens and the state. And Europeans have been struck in recent years by terrorist acts that have created an anxiety syndrome. Terrorism, unconventional dangers (including cyber-attacks, hybrid wars), fear of the future, great uncertainties, cause many citizens to demand firm measures from national governments. In France and Belgium, for example, operate emergency situations. New security measures proliferate. In Europe the crisis of refugees, of immigrants, has made the functioning of the Schengen space worse. Within this generalized atmosphere of uncertainty, we are witnessing a resurgence of national interests (of nationalism) in a world with great disturbances, with redistribution of economic power (multipolarization and disorder - what Ian Bremmer calls "G-0" vs. G-20 or G-7, multilateral institutions) with conventional and unconventional threats that proliferate. (Daniel Dăianu, 2017)

*Macroeconomic implications of rising protectionism*

Intensification of protectionism promoted by the *G-20 countries*. According to the monitoring of commercial and investment measures report regarding the G-20 countries, developed by WTO together with the OECD and UNCTAD, published twice a year with the purpose to monitor and publicly report on the G20 countries trade and investment policy, the current situation (The Twentieth Report on G20 Investment Measures developed jointly by the OECD and UNCTAD Secretariats covers investment policy and investment-related measures taken between 16 May 2018 and 15 October 2018) provides a first factual insight into the trade restrictive measures imposed in the context of current trade tensions. The information provided by the report indicated that global FDI flows have descended by more than 40 percent to around US \$ 450 billion in the first half of 2018 compared to the same period in 2017. This decline was largely due to significant repatriations of US parent companies' profits from their foreign subsidiaries as a result of the corporate tax reform in the United States. Another interesting and relevant aspect delivered by the report we analyzed is that in the first half of 2018, compared with the first half of 2017, FDI inflows to developed economies drop-out by more than 50%, while inflows to developing economies were more stable. The largest FDI sources in the world in the first half of 2018 were Germany, Japan, France, China and the Netherlands. Another interesting and relevant aspect delivered by the report we analyzed is that in the first half of 2018, compared with the first half of 2017, FDI inflows to developed economies drop-out by more than 50%, while inflows to developing economies were more stable. The largest FDI sources in the world in the first half of 2018 were Germany, Japan, France, China and the Netherlands. Surprisingly for the general public is that the US, which has been constantly the most important source of FDI, registered negative investment abroad, the main cause being the fiscal reform. (UNCTAD-OECD, 2018, p.1).

Australia, Canada, China, India, Indonesia and South Africa are the six G20 Member States that have promoted specific FDI measures, part of which liberalizes foreign investment, consisting of: relaxation in air transport in Canada and the issuance of updated negative lists by China, which reduces the number of sectors where restrictions apply to foreign investors. Another situation is that of India that clarified specific investment regulations or Indonesia that simplified bureaucratic mechanisms. In Australia, taxes have been increased for real estate purchases or property ownership by foreigners. Also, if we take the case of South Africa, we find that the new investment promotion act has entered into force with the aim of replacing the system of protection of investment treaties with national legislation. (UNCTAD-OECD, 2018, p.2).

The report also comes to support the concept that protectionism is not based only on economic factors, but has strong links with the national security phenomenon, referring to the situation of three G20 Member States that have changed their investment policies related to national security trying to manage the potential threats to national security that are directly connected to international investment. The increase in national security measures reported lately and the fact that several countries are preparing sets of such measures underline the importance of multilateral dialogue with the purpose of drawing better policies.

To put things in perspective, we also take into consideration previous reports, starting 2008, and we determined that several commitments to refrain from applying new measures affecting trade and global investments and to eliminate the protectionist measures introduced were violated. The introduction of new protectionist measures was found: the number of new restrictive trade measures imposed by these countries constantly increased, reaching the highest monthly average recorded since 2008 in 2016 (UNCTAD-OECD, 2016); by mid-2016 about three-quarters of the cumulative number of restrictive trade measures implemented by the G-20 economies since 2008, such as the imposition of import / export duties or their increases, the introduction of prohibitions on imports or quantitative restrictions, the establishment of more complicated customs procedures, measures on local content and the temporary or permanent introduction of import / export duties, is still in force.

Intensification of protectionism promoted at a *global scale*. From a global perspective, trends in trade policy developments in the last months of 2015 and in the first half of 2016 show the existence of a serious possible threat for the global economic recovery. The results of the latest WTO Trade Policy Monitoring Report, covering the period mid-October 2015 to mid-May 2016, confirm that in the seven months under review there was a clear re-emergence of protectionist

measures at the level of WTO members (WTO, 2016). Not only has the stock of restrictive trade measures accumulated since 2008 continued to increase, but during the monitored period there was an increased number of new trade restrictions targeting both imports and exports as compared to the period precedence. Thus, between mid-October 2015 and mid-May 2016, WTO members implemented a number of 154 new restrictive trade measures. Of the total of 2,835 restrictive trade measures imposed by the WTO members since 2008, only 708 or 25% were eliminated by mid-May 2016, with 2,177 (75%) remaining, which corresponds to a stock increase of more than 11% between October 2015 and May 2016. When analyzing protectionism globally, according to the WTO report mentioned already, three aspects must be taken into consideration: 1. The significant number of non-tariff trade measures materialized in "specific trade concerns" submitted to the WTO Committee are a confirmation of the upward trend in recent years of the number of these concerns submitted to the WTO Committee. Even if, according to the WTO, the increase in the number of notifications does not automatically involve a more intense use of these measures for protectionist purposes, this tendency is symptomatic of escalating the commercial friction between WTO members: 2. Strengthening trade defense measures, which refer to the initiation of investigations that can lead to the imposition of anti - dumping measures, countervailing measures or safeguard measures, and in relation to which the WTO members have an obligation to inform the organization, become an indicator of growth regarding the degree of strain in trade relations between states: 3. general measures of economic support (such as subsidies), implemented by WTO members, have signed upon an ascending trend (WTO, 2016).

These findings complement the different approaches in recent specialized literature, and come to support the idea that the slowdown in world trade may be a phenomenon with temporary implications, even being voices talking about the emergence of a "new normal." However, global trade is unlikely to regain the dynamic registered before the crisis. Finally, it is unlikely that the upward trend of trade in the past, manifested by the rapid process of trade liberalization, the integration of China and the Central and Eastern European countries into the world economy, the reduction of transport and communication costs, will have, in the future, a similar course.

At the same time, the data gathered by specialized institutions reveals that, in parallel with the unprecedented intensification of the countries' recourse to protectionist measures, there have also been changes in the physiognomy of protectionism. Thus, prior to the capping of international trade, the most commonly used protection instruments were the increases in import duties, anti-dumping measures, countervailing duties and safeguard measures, during the capping period of trade, state aid - government bailouts launched in national industries - alongside financial assistance programs and tax incentives moved in the foreground, having a huge potential for distorting international trade.

## 5. Conclusions

Rising protectionism could harm trade and activity. The new protectionism is to be judged not only in commercial terms, since the crisis maneuver invites the state to intervene more in the economy. The crisis of globalization is to be examined from a broader perspective that goes beyond strictly economic aspects. There is widespread consensus among economists on both the overall net benefits of trade openness and the need to cushion the negative impact it has had on certain groups in society. However, raising trade barriers is not the solution to the latter. Reversing trade integration may put at risk the net economic gains that it generated. By unravelling the long-term benefits of closer trade and investment links, retreating into protectionism also has the potential to unsettle global financial markets.

There is a worrying amplification of negative perceptions and attitudes towards trade and the steps taken to liberalize it, in countries and regions around the world, along with obvious signs of the exacerbation of economic nationalism and populism. As European Trade Commissioner, Cecilia Malmström, notes: "There is a paradox at the heart of trade policy today. On the one hand, people on both sides of the Atlantic are benefitting more from economic openness than ever before. They benefit from exports. In the EU, one in every seven jobs depends on exports outside our borders. In the US, the figure for manufacturing jobs alone is a quarter. And these are higher pay and higher skilled jobs. And we need them. We need more of them. People also benefit from

imports. Consumers have access to the products of the whole world, so they can pick the best for their needs. Businesses do too, making them more competitive. And they are benefitting from foreign direct investment. Over 7 million people are employed in the EU and over 6 million here in the US thanks to foreign direct investment. On the other hand, trade is more debated than ever before". (Malmström, 2016). Likewise, beyond the anti-trade and anti-globalization rhetoric, it seems more and more common that international trade has reached its peak, and the process of globalization and, implicitly, the process of global economic integration stopped.

The global economic system is in a process of accommodating with a new situation, of poor and persistent economic growth, where investment returns are low (as well as interest and inflation rates) and incentives for globalization and labor force relocation is gradually decreasing. As the process of globalization is in retreat, it is to be expected that the economy of the future will increasingly acquire a "local" dimension. As a result, the concept of "de-globalization" is no longer just a "political" one with the stagnation of the increase in trade, confirmed by the official data of international economic organizations (Minenna, 2016). Broad political and societal concerns about the impact of free trade can be an important source of protectionist pressure. These concerns arise from the fact that globalization has been perceived as a major contributor to widening wage inequalities in developed countries.

For further research, we are interested to develop the idea released by Evenett & Fritz, regarding the specter of imposing a new type of mercantilism, specific to the 21st century, which, unlike its predecessors in the past centuries, would have the potential to affect a much wider range of trade, taking into account new economic realities, especially within the global trading landscape. The two authors draw attention on the fact that in a world where global trade is no longer growing, governments may tend to gain larger market shares for their exporters just on account of the commercial partners. We believe that the present economic and political context will generate an exacerbation of the competition for foreign direct investment, for a highly skilled workforce, for research and development centers and for intellectual property, tendencies that may conduct to the emergence of a new version of mercantilism.

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