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# Could EU recession lead to more protectionism?

I write this week from Brussels, where I took part in the annual meetings between the Gulf Cooperation Council and European Union. In discussing the crisis in the euro zone, the EU side painted a grim picture: Early predictions that the recession would lift have not been borne out.

Consistent signs indicate that Europe is slipping into recession. Worse yet, the International Monetary Fund warned last Thursday that Europe could face a gloomier fate - stagnation.

I will argue here that this negative twist is self-inflicted, because Europe is resorting to protectionism to deal with its economic slowdown, making matters worse.

European economies continued to contract during the first quarter of 2013, continuing a trend from last year. According to an economists' rule of thumb, when an economy shrinks two quarters in a row, it is officially in recession. For example, the Netherlands has already suffered two quarters of declining gross domestic production, so it is officially in recession.

By that rule, most euro zone countries are already officially in recession; the rest may follow before the end of the first half of 2013.

Until recently, Germany had been spared the worst, as its economy continued to grow, albeit slowly. However, this past quarter saw the economy shrinking in Germany, Belgium, France, Luxembourg, Austria, Sweden and Finland.

## German economic slowdown?

If the trend continues during the current quarter, all euro zone would be in recession, including robust economies such as Germany.

Labor protests in Spain highlighted the depths of recession there, as the official rate of unemployment, exceeded 27 percent this month, the worst in decades.

If Germany enters into recession, as feared, much of the EU would feel the repercussions. If the EU suffers, the global economy would also feel the pinch. The EU is the largest trading bloc and second largest economy in the world. As such its recession would affect its trading partners. For example, the EU is the GCC's number one trading partner. It is also the United States' biggest trade partner, as well as many other countries.

A German recession would cause serious disruptions in global economic recovery and its effects could be felt in energy markets. Oil prices may fall due to shrinking demand, causing revenues of GCC countries to fall as well.

The German economic slowdown is caused in part by weakening exports as Germany is not only Europe's largest economy, but its largest exporter as well.

The current decline in Germany was preceded by months of declining industrial output, due to euro zone troubles, but also due to slowing external demand for its exports. Unfortunately for Germany, its main exports have been sensitive to the global slowdown, such as luxury cars, sophisticated machines, industrial products and construction equipment, the demand for all of which typically declines during recessions.

Part of the cure would then be encouraging trade with regions that have not been affected by the global slowdown, such as the GCC. However, the EU has been doing the opposite - taking measures that would have negative impact on GCC-EU trade.

While the EU remains GCC largest trading partner, its share in GCC trade has been declining. I will illustrate that by comparing the relative shares of the EU and China in GCC trade over the past twenty years. In 1991, GCC trade with the EU accounted for 24 percent of all its external trade, but in 2011 that share has declined by almost half, to 13 percent. By contrast, GCC trade with China accounted for a mere (1.6) percent of GCC total trade in 1991, but that share has grown more than six-fold, to over ten percent in 2011.

If these trends continue, China may overtake the EU as GCC largest trading partner before this decade is over. India and Japan may also overtake the EU in their shares of GCC trade.

The EU has taken a protectionist approach to its trade with the GCC, succumbing to pressures by its petrochemical and other industrial lobbies, which fear the competition from GCC more agile producers against their aging facilities.

During GCC-EU Free Trade Area negotiations, the EU has demanded various measures intended to limit competition from GCC producers. Since 2009, those negotiations have stalled over EU demand to put restrictions on the right of GCC countries to introduce "export duties" when needed, in full compliance with WTO rules.

More recently, the EU has revised its Generalized System of Preferences (GSP), which gives preferential customs tariff treatment to EU imports from some (176) countries. Effective Jan. 1, 2014, the EU GSP will exclude nearly one hundred countries from those reductions, including GCC countries.

These measures are added to the notorious agricultural policy, which makes it difficult for agricultural products to enter into the EU market.

EU protectionist tendencies can only make matters worse in Europe and could lead to a global downward spiral. For if they continue, other economies may take defensive action, leading to further deepening of the global slowdown.

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