

Protectionism and its implications for foreign direct investment flows amid geopolitical tensions

الحماية و آثارها على تدفقات الاستثمار الأجنبي المباشر في ظل التوترات الجيوسياسية

Zeggai hafida* 1

University of Mostaganem- Algeria
hafida.zeggai.etu@univ-mosta.dz

hitla maamar 2

University of Mostaganem- Algeria
maamar.hitla@univ-mosta.dz

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Abstract:

Rising geopolitical tensions, such as trade wars, economic sanctions and regional conflicts, are resulting in major transformations to global economies, directly affecting protectionism and foreign direct investment (FDI).

Protectionism consists of trade restrictions, such as tariffs and non-tariff barriers, as well as favoring domestic products.

It interacts with foreign direct investment flows in an intricate context where economic and political factors are intertwined.

Therefore, it is necessary to adopt economic and trade flexibility, and fulfill the commitments made within the framework of the World Trade Organization(WTO), especially those related to facilitating the flow of foreign investments and liberalizing international trade.

Keywords: protectionism, foreign direct investment, geopolitical, world trade organization, trade, tariffs, non-tariff.

* *Corresponding author : international law for sustainable development lab*

Introduction

In recent decades, the world has witnessed a real revolution in the nature of economic relations, which have become increasingly independent among countries.

The beginning of this revolution was the advent of world economic globalization, which transformed the world into a single commercial market that knew no restrictions and barriers and recognized the principle of free flow of production, liberalization of international trade and flow of foreign direct investment.

Foreign direct investment has become one of the most economic variables for policymakers.

However, in recent years, the global economic landscape has been characterized by the return of protectionist measures and the escalation of trade disputes.

This shift towards economic nationalism, with major economies imposing tariffs and trade barriers, reveals a new gray area, indicating a state of uncertainty in international trade, economic growth and geopolitical relations, thereby creating contradictions and diversified risks.

Recent economic research suggests that the impact of geopolitical tensions on Foreign Direct Investment (FDI) flows may be stronger and more direct than on trade flows alone.

As firms seek to mitigate political risks, investment data clearly indicates that announced FDI flows between the U.S.-led bloc and the China-led bloc have dropped by over 20% compared to intra-bloc investment since the war in Ukraine began. These findings provide strong evidence that FDI flows have already begun to fragment and reorient along geopolitical lines.

Based on the above, the research question can be formulated as follow:

How can countries implement protectionism while simultaneously attracting FDI amid geopolitical tensions?

Several sub-questions arise from this question in order to answer the main question, namely:

- 1 - What is protectionism and what are its tools?
- 2- What is the impact of protectionist policies on the global economy?
- 3- What is the protectionist approach?

Firstly: protectionism: Concept and Tools

Protectionism is one of the economic policies adopted by some countries in order to restrict the freedom of trade through some practices, such as raising customs duties on imported goods and limiting their quantity, and preventing foreigners from taking over national markets.

1. Definition of Protectionism:

Protectionism is defined as a set of standards and methods that restrict international trade markets to achieve the commercial interests of countries .

As a comprehensive definition, it is the set of standards and methods aimed at strengthening the positions of national output in domestic, and foreign markets beyond all traditional forms of support and protection, represented in several forms:

- ✓ discriminatory treatment in various forms.
- ✓ government support and rescue programs for national institutions and companies impact the external values of national currencies¹.

2. Protectionist Tools:

2.1- Customs Duties (fees)²: an indirect tax imposed by the state on the good when it crosses the customs border, either in the form of imports or exits the form of exports, and is often imposed on imports, and is divided into three main sections:

- **Ad Valorem Duties:** these are determined by a certain percentage of the value of the commodity, and this percentage varies from one commodity to another.

- **Specific Duties:** these are a fixed amount charged for a unit of a commodity such as weight, volume or number.

- **double fees:** these are both value-based (ad valorem) and specific

2. 2 - Import Quotas³: this is a direct restriction on the amount of goods that can be imported annually, the government determines the amount of each commodity that can be imported, and grants licenses to local companies to supply these commodities within the specified quantities.

2.3 - Anti- Dumping: it is the sale of a commodity at a price lower than the cost of producing it, or selling it at a price lower than in the exporting country.

This practice is considered a form of unfair competition and is therefore condemned in all international trade agreements.

2.4-Competition Policy and Restrictive Practices of International firms⁴:

These are procedures taken by international companies to limit competition and exclude outsiders and new entrants, leading to strengthening of the position of these companies, either individually or by consolidating their market power with other companies.

These measures are imposed by dominant companies on smaller suppliers and distributors.

Examples include resale price maintenance, agreements, discount bans, export bans, refusal to deal, and virtual pricing.

The new protectionist measures can be categorized under non-tariff measures, which include a variety of policies and measures that countries apply to imported, and exported goods in addition to the traditional licensing, quotas and prohibitions.

UNCTAD considers these measures to be (policy measures that differ from regular tariffs, and can have economic effects on international trade in goods in terms of changing quantities traded, prices, or both quantities and prices).

Secondly: The Impact of Protectionist Policies on the Global Economy⁵:

protectionist policies have a significant impact on the global economy, placing restrictions on free trade and increasing trade tension between countries, thereby negatively affecting global economic growth and market interconnectedness.

The following are some of the prominent effects of protectionist policies on the global economy:

1. Reducing Global Trade:

protectionist policies lead to a decline in trade between countries as a result of imposing tariffs and quotas, which reduces the volume of goods and services exchanged globally.

protectionist policies disrupt the global supply chains that depend on cooperation between countries, and affect the ability of companies to obtain raw materials or parts needed for production.

2. Reduced Global Economic Growth:

Protectionist policies limit growth by reducing foreign investment and weakening markets, leading to lower GDP in the affected economies.

Reduce trade reduces the efficient allocation of resources between countries, and limits the utilization of each country's competitive advantages.

3. Price Fluctuations and Rising Cost of Living:

The imposition of taxes and customs duties increases the prices of imported products, which increases the cost of living globally, especially for countries that rely heavily on imports.

The rise in the prices of imported basic commodities, may burden the poor classes in developing countries that rely on imports to meet their needs.

4. Reducing Foreign Investment:

Protectionist policies undermine that global investment climate, by reducing the attractiveness of countries that impose trade restrictions.

It reduces investor confidence due to uncertainty in trade policies and the possibility of escalating trade disputes, which affects the flow of capital.

5. Escalation of Trade Disputes:

Affected countries tend to respond with similar measures, increasing international trade disputes and leading to trade wars that reduce the effectiveness of international cooperation.

Trade disputes affect the ability of international economic organizations such as the WTO to achieve their goals of liberalizing global trade, and resolving disputes fairly

6. Reduce Incentive for Innovation: protectionism reduces the incentive for companies to invest in innovation and product improvement.

Trade barriers impede the exchange of technologies and expertise, limiting the spread and advancement of technology globally.

Thirdly: Protectionist Policy and its Implications for the Flow of FDI:

protectionist approach to fdi inflows is characterized by a combination of incentive reforms and structural constraints, reflected in modern policies and laws against economic challenges first, we will address the concept of FDI, and the factors influencing its attraction.

1.The Concept of Foreign Direct Investment by International Organizations and Bodies ⁶:

The definitions of foreign direct investment are as numerous as the number of international organizations, so we will only summarize the most important ones as follows.

2. Organization for Economic Co-operation and Development (OECD):

Every natural person, every public or private enterprise, every government, every group of natural persons who have a relationship with each other, and every group of institutions with legal personality that are related to each other is a foreign direct investor if they have a direct investment institution.

A foreign investment enterprise is defined as: An organization characterized first by a legal personality where the foreign investor owns a share of at least 10% of the ordinary shares or voting rights.

3. United Nations Conference on Trade and Development (UNCTAD)⁷:

FDI is defined as an investment involving a long-term relationship reflecting permanent interests and managerial control between a company in the home country (the country of the investing company) and a company in another country (the recipient country).

4. International Monetary Fund (IMF ⁸):

According to the IMF definition, direct investment reflects the objective of a lasting interest by a resident entity of one economy (the direct investor) in an enterprise resident in another economy (the direct investment enterprise). The "lasting interest" implies the existence of a lasting relationship between the direct investor and the direct investment enterprise and a significant degree of influence over the management of the latter.

Direct investment covers both the initial transaction establishing the relationship between the investor and the enterprise and all subsequent capital transactions between them and between associated enterprises, both incorporated and unincorporated.

5-Factors attracting FDI:⁹

The flow of foreign direct investment (FDI) to a country is due to the favorable investment climate in that country. The investment climate includes all the legal, political, economic and social conditions that make up the environment in which the investment takes place. These conditions may attract or repel FDI.

The most important factors attracting FDI can be summarized as follows:

✓ Political Stability:

Political factors play an effective role in influencing the decision of the foreign investor, especially political stability, which is the necessary assurance for FDI protection from political risks such as nationalization and expropriation, and it has been proven that the foreign investor will not risk transferring his capital and technical and technical expertise to a country unless he is sure of the stability of the political situation in it.

Many studies have shown that the flow of foreign direct investment is affected by the availability of political stability in host countries and that political stability is considered the first or second determinant of the flow of foreign direct investment.

✓ **Market Size and Growth:**¹⁰

What motivates companies to invest in a country is related to the size of the market, but it is not the size of the market itself that matters as much as the future development and growth of the market. Foreign investors are more attracted to regions that are experiencing great dynamism and expansion of their markets and that offer new opportunities for investment, meaning that it is not enough to have a large market size as a prerequisite, but the market size must be dynamic, which applies to Southeast Asian countries.

✓ **Legal factors:**¹¹

A unified investment law characterized by clarity, stability, transparency, and non-conflict with other investment legislation.

-The existence of an effective financial and fiscal incentive system to attract foreign investment.

-The existence of a judicial system capable of resolving disputes that may arise between the investor and the host country with high efficiency.

-Adequate safeguards to protect the foreign investor from all risks such as nationalization and guarantee the free transfer of capital and profits abroad.

✓ **Tax Incentives:**¹²

These include permanent exemptions from taxation or the provision of discriminatory rates of taxation, exemptions in the field of import rights on raw

materials, intermediate inputs and processing goods, or reduction of customs duty rates. Among the countries that have used this method is Brazil for the equipment and machinery it needs in the production of cars in order to establish a local automotive industry, as well as granting favorable customs treatment to imports of automotive parts that were not produced in Brazil.

✓ **Freedom of Capital Transfer:**¹³

The protection of the freedom of capital transfer is one of the most important objectives of the foreign investor, as most of his investment activities are based on the transfer of capital and investment returns to his country of origin. For example, in Algeria, the legislator has not overlooked this matter, as Article 25 of the Investment Promotion Law No. 16-09 enshrined the guarantee of the transfer of investor capital and the resulting returns for all investments made from shares of capital in the form of cash shares imported through the bank.

6-The impact of geopolitical tensions on foreign direct investment:¹⁴

Investment flows are a key driver of global economic growth. When companies and individuals invest in new projects or expand existing ones, they create additional jobs, increase production, promote technological development, boost trade, and diversify the economy.

In the past few decades, global investment flows have witnessed

major shifts driven by several factors such as geopolitical tensions, such as the Russia-Ukraine crisis and the tense trade relations between the United States and China, which affected investment decisions, with some sectors such as manufacturing and mining industries benefiting, for example, South Korean company Samsung has moved its Chinese manufacturing to Vietnam and Apple began to do the same and WalMart has shifted some production from China to Mexico, there are few signs that ongoing geopolitical conflicts being resolved .

7-The Resurgence of Protectionist Policies is Deeply Intertwined with Geopolitical Risks (GPR)¹⁵ :

The imposition of greater trade barriers by developed nations, often in an attempt to curb capital outflows and promote domestic employment, is found to be a key factor contributing to the rise in geopolitical risks. This creates a negative feedback loop where rising geopolitical tensions lead to states adopting nationalistic, protectionist policies aimed at restricting the flow of goods and services. Consequently, as geopolitical tensions escalate, global political risk increases uncertainty, leading to a demonstrable decline in both international capital flows and trade volumes. Research using quantitative models shows that a mere 10% increase in geopolitical risk is associated with a significant decline in FDI and overall trade. Furthermore, the effects of GPR on FDI inflows are particularly high during times of overt conflict, such as the war between Ukraine and Russia. This underscores the critical role of strong institutional structures, as a robust regulatory system and good governance serve as a stabilizing force that can mitigate the uncertainties of a high-GPR environment, thereby promoting resilience in international investment and trade activities.

8. Protectionism as a Response to Geopolitical Tensions:¹⁶

The policies of trade liberalization and FDI have brought gains to those who practiced them, resulting in high rates of economic growth, an increase in the volume of international trade by 20 times since the 1960s, and a decrease in the number of people suffering from extreme poverty by 10% of the world's population. since the beginning of the 1990s.

In contrast, protectionist measures emerged, many of them were improvised, reactive, and, experimental, they were generally invoked to address climate change and promote green transformation, and also invoked the protection of general economic interests and support for the poorest segments of society and the middle class, which bear the heavy costs of subsidies, debts and inflation.

The protection of public economic interests and support for the poorest segments of society and the middle class, which bear the heavy costs of subsidies, debt and inflation, is often met with retaliatory measures from trading partners.

this has already happened and threatens more geopolitical tension and increased confusion in supply chains, all of which has an impact on the economies of developing countries and the formulation of their priorities and financing policies in the midst of flowing waves of subsidies, taxes and protectionist duties .

9. International Legal Framework on Protectionism:

International laws on protectionism and FDI flows in the context of global tensions include a range of international agreements and legal frameworks that aim to regulate trade and investment across the world while balancing the protection of national interests and promoting economic cooperation in the context of geopolitical tensions.

10. World Trade Organization (WTO) Perspective:

The experience of the GATT has shown that national laws on investment may affect the freedom of international trade, which led to the quest to liberalize the international investment sector by integrating it into the WTO agreements and establishing a set of principles aimed at removing all restrictions that may conflict with the GATT principles to ensure the normal functioning of international trade.

The organization allows countries to impose protectionist measures in exceptional cases such as protecting national security under Article 21 of the GATT, which is intended to protect vital industries such as technology or energy.

Article 20 allows countries to impose trade restrictions to protect public interests such as protecting the environment and natural resources.

Article 18 gives developing countries flexibility to protect their emerging economies such as supporting infant industries through tariffs.

Article 06 includes anti-dumping and anti-subsidy agreements that allow countries to impose duties on products imported at below-market prices if they cause harm to local industries.

Article 16 allows the imposition of countervailing duties on products subsidized by foreign governments if they harm local industries.

For example, the European Union has imposed countervailing duties on products subsidized, by foreign governments

11. Protectionist Responses to Crises and Global Shocks :¹⁷

in line with the framework established in this document that major global shocks intensify protectionism analysis from the European Central Bank (ECB Occasional Paper No. 110) on the aftermath of the 2008-2009 Global Financial Crisis offers a crucial historical parallel. The ECB paper highlighted that the surge in protectionist measures was primarily conducted through non-tariff barriers (NTBs) and domestic subsidies, rather than explicit tariffs, indicating a move toward more "disguised" forms of protection. This crisis-driven protectionism was found to create significant uncertainty, disrupt global supply chains, and undermine the multilateral trading system. This historical evidence strongly reinforces the argument that regardless of whether the shock is financial or geopolitical, its resultant protectionism threatens free trade and creates instability, thereby necessitating strict global adherence to WTO commitments to safeguard Foreign Direct Investment (FDI) flows.

12. Protectionist Threats and Anticipatory FDI Behavior¹⁸:

The economic analysis by Blonigen and Feenstra (1997) expands the traditional notion of "tariff-jumping" to include the profound impact of protectionist threats on investment decisions, even before trade restrictions are formally enacted.

The paper posits that foreign firms may preemptively increase their Foreign Direct Investment (FDI) in a host country, essentially treating it as a "policy of insurance" against the risk of future tariffs or non-tariff barriers. By establishing a local production presence, the firm secures market access should geopolitical tensions escalate and trigger new trade barriers.

This anticipatory FDI behavior is particularly relevant in the current geopolitical climate, where uncertainty is high. The study demonstrates that the mere probability of protectionist measures—a direct consequence of geopolitical tensions—can be a powerful incentive, effectively redirecting FDI flows as a defensive strategy against political risk.

Conclusion

The international reality makes the major western industrialized countries respond to the dictates of the national interest of their economies, and continue to protect what can be protected from their production by pursuing protectionist policies, especially in the field of technology.

Trade exchanges are considered a gateway to open up to international markets however in reality , the trade practices of major economic, and industrial countries allow the use of price , customs, and quantities methods such as quotas and import licenses, which has little to do with international trade integration, which creates foci of competition, and tension between countries, WHERE each of them resorts to adopting protectionism, and racing among themselves to occupy strategic positions in international trade, and activate FDI flows, which leads to the emergence of geopolitical tensions ,and international commercial wars .

The main findings of this article are as follows:

- A significant quantitative finding confirms the direct link between rising global protectionism and the decline in Foreign Direct Investment (FDI). Estimates suggest that 30% of the observed decline in inward FDI in major economies between 2018 and 2022 can be directly attributed to new protectionist measures. This impact is particularly severe in strategic sectors such as semiconductors and high-tech industries where the effect of protectionist measures is approximately five times greater than in non-strategic sectors. This concentration in strategic sectors is highly concerning as it threatens the long-term erosion of technological capacity and sustainable economic growth globally. Crucially, the paper finds that the main driver is not solely direct US-China competition, but rather a broader increase in global protectionism, primarily through reshoring initiatives that indirectly impact major economies and are likely to have significant negative spillovers for other developing countries¹⁹.

-FDI is the main source of capital inflows and increases a country's hard currency reserves, contributing to economic growth and development

- FDI contributes to many benefits for host countries, including supporting economic growth, creating new jobs, reducing unemployment rates, and contributing to raising the standard of living of members of society

-FDI facilitates the transfer of modern, and advanced technologies to developing countries to develop their economies.

-Protectionism is the main cause of geopolitical tension and trade wars between countries.

This means that countries use protectionism to protect and defend their national economies in the face of what is known today as opening up to international markets.

- Protectionism will increase geopolitical tension and trade wars and will negatively impact the global economy by driving up inflation rates, leading to higher interest rates, slowing down international investment, and hindering the flow of international trade.

- Protectionism exacerbates debt, and lowers consumption rates in all countries of the world, increasing poverty, unemployment and low growth rates.

Margins:

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