



Research Report

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Student Officer: Anke van Vliet
Issue of: The issue of economic polarization due to protectionism and federal policies



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Forum: ECOSOC

Name: Anke van Vliet

Position: Chair

Introduction

“Pursuing protectionism is just like locking oneself in a dark room: Wind and rain might be kept outside but so are light and air.” ~ Xi Jinping

This quote from Chinese president Xi Jinping perfectly describes the initial answer to the question, as to why countries seek to protect themselves and their citizens by means of protectionism. Excerpt from a report by the European Parliament: “In its narrowest definition, protectionism refers to the restriction and/or distortion of trade flows enacted through tariffs and quotas. On a broader scale, it encompasses all government regulations and policies intending to protect domestic industries.” Federal policies are implemented in order to increase prices and tolls for foreign products and services, whilst decreasing tariffs and prices for local products. This way, governments hope to achieve a growth in the buying of locally made materials and products, thus increasing their country’s financial capital and safeguarding domestic businesses and industries. However, protectionism does have its downsides, as the quote also reveals.

Protectionism can and has led to widespread economic polarization, loosely defined as the gap between the ‘haves’ and the ‘have-nots’ in society by the State and Local Government Review (2016). Wealth and income inequality have always been problems international organizations, such as the UN, have fought against. The issue of economic polarization due to protectionism and federal policies has been a continuous problem, implemented at both major economic breakthroughs and setbacks throughout history. Historical evidence suggests that as early as along with the creation of the Silk Road, protectionist measures have been put in place for economic gain. However, over the past couple of years, an increase in protectionism and the implementation of tariffs can be seen. In particular, bilateral tariffs on trade between the US and China have risen substantially, with large consequences for the rest of the world.

In this report, the history of protectionism and economic polarization will be discussed, along with the current situation and the major contenders in protectionism. Previously undertaken steps will be described and those still to be taken.



Definition of Key Terms

Polarization

Division into two sharply contrasting groups or sets of opinions or beliefs. (Oxford Dictionaries). Economic polarization can then be defined as economic division, in terms of wealth, income and its distribution. Can be considered as the opposite of income and wealth equality.

Protectionism

"Refers to the restriction and/or distortion of trade flows enacted through tariffs and quotas. On a broader scale, it encompasses all government regulations and policies intending to protect domestic industries." (European Parliament)

Tariff

Also known as duty: a tax that a country imposes on its imports and, occasionally, exports. A duty exists to make an import more expensive and to thereby encourage people to buy goods produced in their own country. (Financial Dictionary)

Trade Flows

Trade flows are the buying and selling of goods and services between countries. Trade flows measure the balance of trade (exports – imports).

Demand-led growth

Demand-led growth is the foundation of an economic theory claiming that an increase in (aggregate) demand will ultimately cause an increase in total output in the long run.

Mercantilism

Belief in the benefits of profitable trading. (Oxford Languages)
Historically, mercantilism was an economic practice by which governments used their economies to augment state power at the expense of other countries. Governments sought to ensure that exports exceeded imports and to accumulate wealth in the form of bullion (mostly gold and silver).

Laissez-faire

The policy of leaving things to take their own course, without interfering. Abstention by governments from interfering in the workings of the free market. (Oxford Languages)

GDP

Gross domestic product (GDP) is the total monetary or market value of all the finished goods and services produced within a country's borders in a specific time period. As a broad measure of overall domestic production, it functions as a comprehensive scorecard of a given country's economic health. (Investopedia)

Class Identification

Class identification is the extent to which a citizen of a country identifies themselves as members of a certain social class, and whether they do so in the same way as market researchers and political scientists do.



General Overview

Essentially, protectionism is a consequence of a fear for loss of influence on the global economic market. A country assumes that via protectionist measures, it is safeguarding its position on the market and protecting its own economy and domestic industries.

However, trade barriers make it more costly, or more difficult, for domestic businesses and consumers to buy goods from abroad, reducing trade flows. These barriers often take the form of tariffs, which for a given exchange rate increase the price of imported goods relative to those that are domestically produced. Non-tariff measures including import quotas or changes to regulatory standards can also create barriers to trade.

A rise in the cost of imported goods due to tariffs will lower real incomes and in turn weigh on domestic demand growth. Some domestic production which uses imports as inputs might also be constrained if trade barriers cause supply-chain disruption.

Lower trade can reduce productivity growth as businesses are less exposed to global competition and new ideas, less able to exploit comparative advantages by specializing, and less able to benefit from economies of scale. Historically, there has been a strong relationship between trade openness and output via productivity. A study by Feyrer (2009) *Opens in a new window*, for example, suggests that a 20% reduction in trade flows tends to drag on output by around 5% in the long run. The integration of global supply chains in recent decades may have intensified that link.

Countries that are not directly exposed to an increase in trade barriers might nonetheless feel some effect from their imposition elsewhere. Some might benefit from positive 'trade diversion' effects if they produce close substitutes for products supplied by those countries that become subject to tariffs. Most countries are likely to be negatively affected by the reduction in global demand, however, particularly if they supply inputs for affected countries' exports.

Spillovers could also occur via reduced business confidence and increased uncertainty. The introduction of trade barriers may make businesses more uncertain about the potential market for their products and services, and whether further protectionist policies will follow. That uncertainty is likely to reduce business investment, lowering the rate of global capital accumulation and so supply growth.

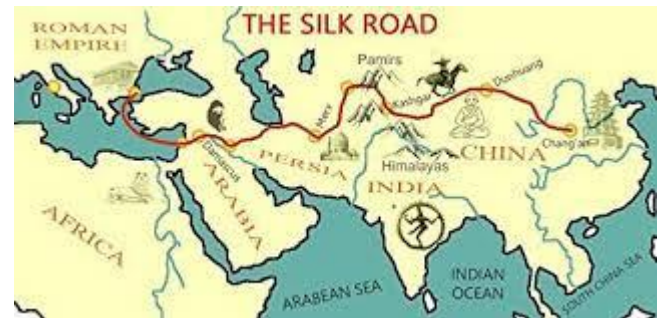
Global financial conditions could also be affected. The price of companies' equity or corporate bonds might fall, for example, if investors expect trade barriers to reduce profitability or increase the risks around it.

Economic polarization is then a consequence of protectionism and other such federal policies, largely due to the mentioned decrease in real incomes. Income equality will begin to diminish, as the rich will mostly stay unaffected by this decrease, while the less wealthy will not have the ability to remain uninfluenced. This was essentially, what countries were trying to protect their citizens from, but it shows that protectionism works counterproductive, usually on a large scale in the long run.

History

In ancient times, trade routes such as the Silk Road, the Spice Route, and the Incense Road were created and supported by governments to facilitate the exchange of goods between civilization centers in China, the Mediterranean, and Europe. During this period, raising revenue, rather than protection of domestic producers, was the primary objective of tariffs. For example, revenues from tariffs were used to build and maintain bridges and roads to make trade possible. However, China, between the late tenth and thirteenth centuries, maintained strict control over maritime trade by monopolizing exports, restricting trade to a few ports, imposing tariffs on imports, and regulating the purchase of traded Chinese goods. Trade was also a persistent issue in the relationship between Europe and the East.

For example, the Crusaders banned trade with their Mediterranean foes, and only after conquering the eastern Mediterranean did they open it to European shipping.



In the sixteenth century, with the rise of nation-states, mercantilists introduced a formal analysis of winners and losers in trade and exercised protectionist policies lasting through the eighteenth century to accumulate gold and silver for armies. The mercantilists maintained that precious metals were the only things of value. In France, Jean Baptiste Colbert (1619-1683) brought all aspects of production under state control, including luxury goods, in order to improve industry in the colonial empire. To stimulate trade, the French government established an alliance with business by building and repairing canals and even subsidizing shipbuilders and shippers. Also, to defend French industry against foreign competition, Colbert imposed tariffs on imported cloth and subsidized the settlement of Dutch weavers into France. To discourage domestic consumption of exportable luxury goods, excise taxes known as sumptuary taxes were imposed. However, the extreme protectionist policies of Colbert did not bring prosperity to the French economy because the costs of such intervention exceeded the value of the benefits.

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At the start of the Industrial Revolution in the late eighteenth century, as belief in the protectionist policies of the mercantilists was dwindling, the view that land is the source of value became popular and the *laissez-faire* policy was introduced, according to which there should be no tariffs on the export of agricultural goods. Later, the English classical economists Adam Smith (1723-1790) and David Ricardo (1772-1823) rebelled against the mercantilists' protectionist doctrine. Assuming what was called later perfect competition, Smith viewed unconstrained expansion of markets through free international trade as a powerful force providing additional opportunities for specialization and the division of labor.

Historically, changes in economic theories seem to have motivated changes in government trade policies, though the direction of causation is not always clear. With the new ideological tool of *laissez-faire*, government policies moved toward more free trade during the nineteenth century. In the late nineteenth century, a revolution in shipping and an expansion of railways contributed to falling transportation costs, offsetting rising tariffs. The use of trade barriers rose during the twentieth century's two world wars. However, after World War II (1939-1945),

international organizations, such as the General Agreements on Tariffs and Trade (GATT), brought order to world trade by allowing a multilateral system of rules for government trade policies. During the oil and financial crises of the 1970s, protectionism tended to expand again in world trade. However, the Uruguay Round of the GATT trade negotiations led in 1995 to the formation of the World Trade Organization (WTO), which provides a forum for trade negotiations and dispute resolution among member states. The WTO has experienced some success in reducing trade barriers and reaching agreements in the areas of financial services, telecommunications, and information technology. In agriculture, however, reducing subsidies among developed countries has remained a challenge for the WTO.

Current situation

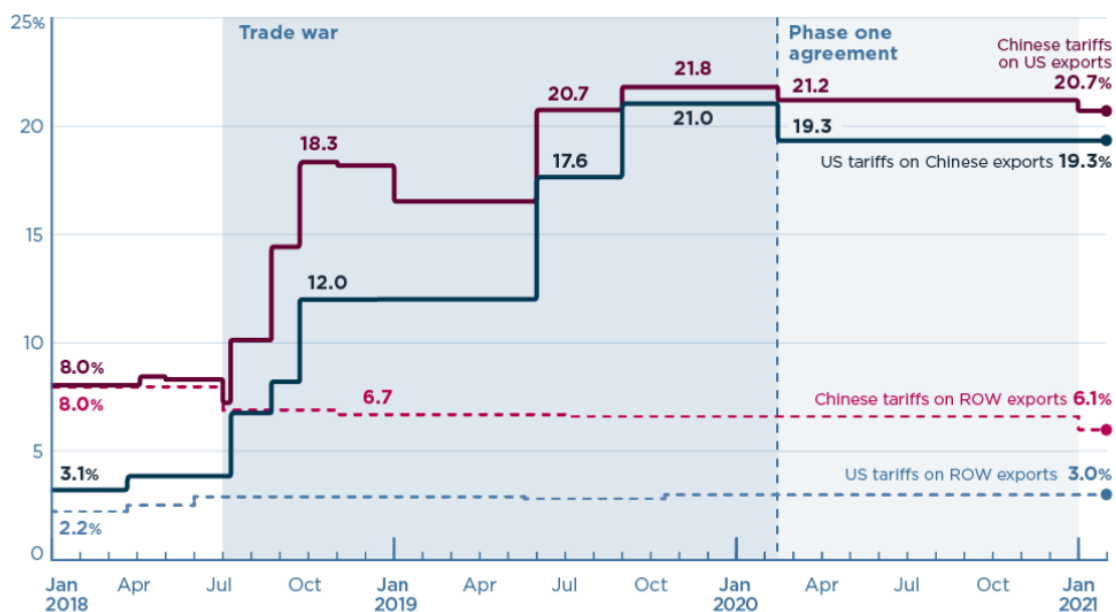
As mentioned above, the WTO has been successful in a large part of their attempts to decrease protectionist measures and improve global economic liberalization over the past fifty years. As a consequence, the Bank of England has observed a steady decline in the global tariff rate, which fell from 8½% in 1994 to 2½% in 2017.



Since then, this trend seems to be reversing. Tariffs on goods traded between the US and China have been increasing since mid-2018. In the second quarter of 2019, the US had levied tariffs on a total of US\$250 billion of imports from China, with China implementing tariffs on

US\$110 billion of imports from the US in response.

In September of that year, US tariffs on a further US\$112 billion of imports from China came into effect, and China responded with measures applied to some goods on a US\$75 billion target list of US imports. As a result, bilateral tariffs between the US and China are estimated to be around 15 percentage points higher than at the start of 2018. The initial waves of US tariffs on Chinese imports were predominantly levied on industrial supplies and capital goods, but more recent tariffs have affected a broader range of products, including consumer goods.



US-China Tariff rates towards each other and the rest of the world (ROW)

While there are some more recent examples of measures that reduce trade barriers — the EU and Japan agreed a trade deal which came into force in February 2019 for example — the number of protectionist measures introduced around the world over the past couple of years has been much larger. Some of these have raised non-tariff barriers. Japan, for example, has imposed restrictions on exports of certain raw materials to South Korea. Tariffs between countries other than the US and China have also increased. The US introduced new tariffs on US\$7.5 billion of imports from the EU in October 2019, following a long-running dispute over state subsidies to aircraft manufacturers.

Looking back at the US-China trade conflict, those sharp declines in US-China bilateral trade flows might have been expected to lead to a boost to trade elsewhere as demand is diverted to other regions, but there has been little evidence of this so far. The rate of growth of US imports from some Asian economies such as Vietnam and Cambodia has increased since mid-2018, but imports from China are more than five times as large as from those countries combined. For most of the largest emerging economies in Asia, growth of exports to the US has not risen to the same extent. That suggests that the negative effect on those countries from disrupted supply chains may have more than offset any positive effect from trade diversion.

The direct effect of increased protectionism on world GDP growth via trade flows, supply chains and import costs appears to have been modest. That reflects the fact that tariffs to date have been largely contained to the two countries. However, protectionism combined with tightening financial conditions have led to a steep decline in global business confidence and associated pickup in uncertainty. All these factors combined have led to a notable decline in global trade growth. World trade growth fell by 5½ percentage points in 2019, of which around 2½ percentage points is accounted for by lower imports growth in the US and China.

Alongside this lower global trade growth, global GDP growth fell by 1 percentage point. Consequently, a severe decline in world trade growth aids economic polarization, as trade flows are reduced, and thus real incomes decrease.



As trade measures have become more widespread, the stated aims of trade policies have broadened significantly. Initially motivated by concerns over bilateral trade imbalances, trade measures are now being introduced in response to a range of issues, including immigration, intellectual property protection and control of new technologies. Protectionist measures could become more pervasive and persistent: over a third of respondents to a recent Bank of America Merrill Lynch survey considered the US-China trade war to be the 'new normal' with no expectation that it will be resolved.

Since mid-2018 and prospects provided since 2019, the global economic market has rapidly undergone large changes due to the current ongoing Covid-19 pandemic. When the COVID-19 pandemic hit in 2020, the trade war between the US and China faded into the background, but still continues to ravage the U.S. economy even under the new Biden administration. No changes have been made to the tariff



structure, whilst the Biden administration is said to be examining the trade deal made by the Trump administration.

Due to Covid-19, a small form of protectionism has arisen in several countries across the globe. Not protectionism, in the sense of tariffs and quotas, but through the restriction of the release of Covid-19 vaccines by the manufacturing country or the unwillingness to send spare Covid-19 vaccines to countries unable to pay for them. For example, tens of millions of AstraZeneca vaccine doses manufactured in the United States are awaiting clinical results to be distributed in the United States, while countries that have authorized its use request access, but do not receive it. Additionally, many wealthier countries have not contributed (sufficiently) to a World Health Organization effort to eradicate Covid-19 globally, via the so-called COVID-19 Vaccine Global Access (COVAX) Facility. Dr. Tedros, head of WHO, criticized wealthier countries for undermining Covax, by ordering multiple times more of a vaccine supply than they need for their populations or not donating spare vaccines to the COVAX Facility.

This is a form of protectionism, since it opposes global trade, deliberately placing one's country before others, in order to gain a better place, faster, in the global economy after this pandemic is over. The phenomenon has gained in publicity and been given a name: "Vaccine nationalism".

As could be seen at other times of economic crises in history, protectionism is ever present and disruptive, a major cause of economic polarization increasing rapidly.

All in all, it is unlikely that trade conflicts will diminish in number in the near future. Through this, protectionist measures will also not cease to be implemented and thus will remain to benefit economic polarization. The consequences of major economic polarization will be detrimental to our global economy, further diminishing economic development due to income inequality.

There is also evidence provided by the *World Values Survey*, that income inequality has an important polarizing effect on class identification and will help create an altogether polarized world.



Major Parties Involved

World Trade Organization (WTO)

The World Trade Organization (WTO) is the only international organization dealing with the global rules of trade. Its main function is to ensure that trade flows as smoothly, predictably, and freely as possible.

United States

The United States (in 2019) is the number one economy worldwide in terms of GDP. Currently, the United States is in a conflict of trade with both China, and on a smaller scale with the European Union. Over the past two decades, the United States has



been the second largest initiator of trade defense instruments in the world. In the United States, the income gap between the rich and everyone else has been growing markedly, by every major statistical measure, for more than 30 years, where the richest 0.1% Take in 196 times as much as the bottom 90%.

China

In 2019 China was the number 2 economy in the world in terms of GDP (current US\$) and the number 1 in total exports. China has been in a trade war with the United States since the bigger part of 2018, with a large increase in tariffs on both sides. In 2019, China reached a score of 46.5 (0.465) points on the Gini Coefficient Index. Most protectionist measures worldwide are imposed against China.

European Union

The European Union operates as a single market with 27 countries, making the EU a major world trading power. As a consequence, the EU gross domestic product (GDP) in 2019, when the UK was still part of the EU, was €16.4 trillion. The European Union has set out a new open trade policy: 'Open Strategic Autonomy', in order to build on the EU's openness to contribute to the economic recovery by supporting green and digital transformations. The Gini Coefficient stands at an average of 0.30 across OECD-EU countries, slightly below the OECD average (0.31).

Apart from these, Mexico, Japan and India are also large practitioners of protectionism.

Timeline of Key Events

Tenth and Eleventh Century a.C	China introduces protectionism for the first time, along the Silk Road, Spice Route and Incense Road.
Sixteenth Century a.C	Mercantilism is introduced
Late Eighteenth-Century a.C	Start of the Industrial Revolution and the concept of <i>laissez-faire</i> is initiated.
1 January 1948	The General Agreement on Tariffs and Trade (GATT) is launched, multilateral system of rules for government trade policies.
January 1, 1948	Founding of the World Trade Organization (WTO).
2008-2009	The Great Recession of 2008-2009, a global economic crisis, caused by deregulation in the financial industry.



January 20, 2017	The 45th president of the United States, Donald Trump, is inaugurated
July 2018	US President Donald Trump followed through on months of threats to impose sweeping tariffs on China for its alleged unfair trade practices.
October 28, 2018	The UN General Assembly considers the implementation of an Annual Report of the Organization's Work on the Defense against Rise in Protectionism and Unilateralism, at the seventy-third session of the GA. (GA/12075)
November 26, 2019	Second Committee Approves 28 Resolutions, Including on Combating Protectionism, Eliminating Unauthorized Unilateral Trade Measures. (GA/EF/3528)
January 15, 2020	First signs of a truce were seen, when the two sides signed the Phase One Deal, which officially agreed to the rollback of tariffs, expansion of trade purchases, and renewed commitments on intellectual property, technology transfer, and currency practices.
April, 2020	COVID-19 Vaccine Global Access (COVAX) Facility is founded
January 20, 2021	The 46th president of the United States, Joe Biden, is inaugurated.
January 25-29, 2021	7th Asia-Pacific Trade & Investment Week, reviewing the impacts of rising protectionism and the COVID-19 pandemic, and promoting inward and outward foreign direct investment in the post-COVID-19 era.
March 1, 2021	Report is released by the Office of the U.S. Trade Representative, stating President Joe Biden's administration will use "all available tools" to fight China's unfair trade practices.



Previous attempts to resolve the issue

The first and foremost notable attempts to resolve the issue were the creation of the General Agreement on Tariffs and Trade (GATT), a multilateral system of rules for government trade policies in 1948 and later the founding of the World Trade Organization in 1995. Both these organizations aim to improve global trade, its regulations and transparency. Secondly, the issue of protectionism has been an agenda item of the United Nations and its various bodies for a long time, creating a platform for talks and clarity on the importance of resolving the issue. Many resolutions have passed, though the issue still remains. For example, the 7th Asia-Pacific Trade & Investment Week reviewed the impacts of rising protectionism and the COVID-19 pandemic, promoting inward and outward foreign direct investment in the post-COVID-19 era. Concerning the trade conflict between the United States and China, a conflict based on protectionism and furthering economic polarization, small steps have been taken in resolving the conflict: The Phase One Agreement is under examination on both sides.



In regards to economic polarization as a whole, particularly income and wealth inequality, many initiatives have been ongoing since the issue was first introduced. NGOs and governments around the world have initiated programs to fight against this inequality. Many governments especially have taken steps to ensure a safety net is in place for its citizens if/when an

income should become severely insufficient.

Possible Solutions

A plethora of solutions could be adequate in solving this issue as a whole or in parts. Such past initiatives, seminars on the issue, making it an agenda item for UN Bodies and in WTO conferences are all necessary in boosting the issue's notoriety with the concerned parties. Another solution consists of promoting and improving the necessary safety nets provided by governments in the fight against income and

wealth inequality. The creation of monetary funds for the resolvment of this issue is also a good start.



The only truly effective way of fighting economic polarization though, as an effect of protectionism and federal policies, is finding a lasting solution, while first of all making governments, heads of state and trade offices aware of the detrimental effects and downsides of

protectionism; how at first it may seem like a good solution, but in the end could do more damage to domestic industries than benefit them. Economic polarization will continue to grow, slowly enlarging the already existing gap between rich and poor, and so swift action is also necessary.



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