Group of Twenty

Research Report

The Question of:

The impact of tariffs on the global economy

Introduction

The interconnectedness and innovation of our global society are heavily dependent on our international trade. For millennia, countries have been trading goods, all with the goal of generating profit and furthering their economy and developing their country. Tariffs are barriers to international trade which are often used for protectionism means. According to many economists such as Paul Bairoch, historically, protectionism is the rule, and free trade is the exception. This concept elicits many questions such as: "Is protectionism necessary?", "Is protectionism fair?", "Is it more beneficial for countries to work towards free trade?", "Who would benefit from free trade?" and many more. This research report will examine these questions with the aim of determining the state of our current global market and how we need to move forward.

Trade barriers are the most prominent form of protectionism in our global economy and are both extremely relevant and controversial, with strong arguments for both free trade and protectionism. Some argue that protectionism will support domestic industries, subsequently increasing the income in that country and therefore bettering the standard of living. In contrast, many others argue that free trade policies promote the specialization of industries, with every country maximizing their efficiency in a particular industry which will lower the total cost of goods. Additionally, free trade promotes innovation as the import of cheaper or higher quality goods will force the domestic firms to increase the quality of their products or lower the prices, the former being a foundation for innovation. According to those who argue this standpoint, free trade would establish fair competition in the global market, create more business opportunities and jobs, and foremost, further develop countries.

The Committee

The Group of Twenty is an international forum consisting of the world-leading industrialised nations. In total, the Group accounts for 85% of the world GDP and two-thirds of its population. Much of the important discussions are held on the sidelines and in informal meetings.

The Group of Twenty was established in December 1999 in Berlin, Germany as a meeting between finance ministers and central bank governors hosted by the German and Canadian ministers. Originally the G20 meetings were solely for finance ministers, however, after an inaugural meeting between G20 leaders in Washington DC as a reaction to the collapse of the Lehman Brothers in 2008, leader's summits became an annual event.

The chairmanship rotates annually between the party states; the country that holds the presidency gets to invite additional nations who are not a party state. Throughout LEMUN, the guest delegations in the G20 will have the same rights as a normal delegation, except for their vote which is only advisory.

Key Terms

Tariffs

Tariffs are a tax on import goods and services that governments put in place as a means of protectionism. Goods imported from overseas are therefore more expensive and these goods subsequently become less competitive in comparison to the local goods that do not have to pay this tax.

Protectionism

A political and economic term for the protection of domestic firms and jobs from foreign competition through governments-implemented policies and actions that restrict international trade.

Domestic Industries

A domestic industry is a set of manufacturers that produce goods within its country of origin.

Dumping

According to Investopedia, dumping is defined as "when a country or company exports a product at a price that is lower in the foreign importing market than the price in the exporter's domestic market. Because dumping typically involves substantial export volumes of a product, it often endangers the financial viability of the product's manufacturers or producers in the importing nation." (Investopedia). Though the WTO has reserved its judgment on the topic, however, most countries are not in favour of this practice.

Free Trade

Free trade is the opposite of protectionism, being an economic policy of non-discrimination against imports from and exports to foreign jurisdictions. This is the minimization of protectionist policies such as tariffs, quotas, or subsidies.

Single Market

A single market refers to a trade bloc in which trade barriers are minimized for goods. Member states share common policies and product regulation and allow for the freedom of movement of the factors of production, both capital and labour.

General Overview

How do tariffs work?

Currently, two main types of tariffs are imposed. The first being a *specific duty*, a tax levied on the quantity of goods, which can be measured in various ways such as weight, size, or the number of goods. The second type of tariff is *ad valorem duty*, which is albeit being more difficult to impose, the preferential tariff. The ad valorem duty is a percentage of the foreign or domestic price. This is much more complex considering the value of goods must be established, and consistently re-established to make this tariff effective.

For protectionist purposes, however, specific duties are best implemented, since the size of the tariff varies inversely with the price of imports. For example, if a product costing $100 per ton has a specific duty of $5 per ton, they effective duty is 5%. Now if the price of the product drops to $80, the same specific duty still applies, and the effective duty will rise to 6%. This inhibits foreign company's capacity for dumping as it is no longer feasible to sell their products at such a lower price that the local products are unable to compete in their domestic market as the foreign products are subject to a high tax.

Free Trade Agreements & Tariffs

Free Trade Arrangements are characterized by their absence of tariffs. The most discernible example of a Free Trade Arrangement is the European Union's single market. Here, all member states of the EU can profit from free trade and are not restricted by tariffs from other member states. The beginning of the 21st century has seen an increase in these Free Trade Agreements with the ASEAN Free Trade Area (AFTA), the United States-Mexico Canada Arrangement (USMCA) and the Continental Free Trade Area (CFTA) brokered by the African Union (AU) being great examples of this. Despite these trade bloc's free trade arrangements having a positive impact on international trade, there are concerns about its impact on international relations.

Free Trade Arrangements within trade blocs creates a certain dichotomic "them" vs. "us" mentality. This is not only harmful to Less Economically Developed Countries (LEDCs) who may not be part of any trade blocs and lack the competitive advantage to be an attractive country to strike a free trade deal with but it also pitches major trade blocs against each other. This is because free trade arrangements encourage trade between the member parties of the agreement and make it harder for foreign competition to enter those markets, taking away from their economic power.

Advantages of implementing tariffs

The word protectionism is often associated with monopolistic countries that are aiming to combat against efficient economies to the detriment of consumers that have to pay higher prices. However, protectionism, when implemented properly could have certain benefits, most of which only apply in the short term before other countries retaliate. The simplest argument for tariffs is that it is a form of income for countries, especially developing countries. However, many may argue that developing countries who would most profit from this extra income are in no place to set high tariffs as it would force business elsewhere and diminish its trade

One of the key arguments for protectionism is the infant industry argument. Smaller industries that are just starting out find it harder to compete with larger foreign industries that can afford to sell their products at lower prices. This is because of economies of scale where industries profit from the fact that they are bigger and smaller industries struggle to survive. Some economists argue that it is justified for a country to enact protectionism to protect these "infant industries". Furthermore, it gives the industries time to develop their own competitive advantages, so they stand a chance against other foreign competitors.

Protectionism also allows the economy to diversify and more areas to develop. This is because through protectionism, the competition of foreign nations that have a developed economy in a particular industry will be eliminated, so the domestic firms in the same industry can flourish. This allows for the development and diversification of the economy. Furthermore, some key industries need to be protected from foreign competition if the country relies heavily on it. This means that more jobs can be safeguarded and the fundamental pillars of the economy of a country still stand. Protectionism means that businesses are more inclined to hire locally, creating more jobs for domestic workers.

Disadvantages of implementing tariffs

One of the key issues with implementing tariffs is that its results and benefits are generally short-term. If one country puts protectionist policies in place, other countries are likely to follow which creates a protectionism "arms race" of some sorts. This leads to higher import prices and higher consumer prices, effectively defeating the goal of protectionist policies. According to the law of supply and demand, as prices increase, a product falls. Consequently, with higher consumer prices, the sales will also decrease which is heavy to the detriment of the industries the protectionist policies were trying to protect from foreign competition. The increase in prices is not only to the detriment of the industries' sales but also lowers the overall demand for these products which can subsequently cause job losses in other industries as well.

Another issue with protectionism is that it is sometimes used to protect inefficient firms to stay in business which in the end cripple the economy rather than help it. Protectionism can be used to encourage such inefficient firms to stay in business, but in the long-term the firm will fail regardless, being inefficient, and the government will have wasted its efforts and have hindered their international relations.

Major Parties Involved

United States of America (USA)

The United States of America has a long history of protectionist policies, however, in the light of globalization, under the administration of Theodore Roosevelt onwards, the USA has become a major party in International Trade. They are part of the World Trade Organization and has various bilateral, and free trade arrangements. However, under the current administration of President Donald Trump, who wishes to impose further tariffs, USA's policies might shift towards protectionism. Though not having changed protectionist policies, he has taken measures such as withdrawing from the Trans-Pacific Partnership as an incentive to "protect" the USA's economy.

In March 2018, Trump announced that the US would impose a 25% tariff on steel and 10% on aluminium imports. This tariff was imposed in the hope of adding US manufacturing jobs and protecting the manufacturing industry, however, there is a great likelihood that this cost will simply be passed onto the consumers. In general, the President can only impose such tariffs without the approval of the Congress if he believes a certain import to be a threat to national security. The proponents of this tariff on steel and aluminium argue that the US's dependence on imported metals will compromise the US's ability to make weapons and is thus a topic of national security. China was most affected by this tariff as it is dependent on its metal exports to the USA shedding light to the great impact tariffs have on international trade.

China

China is a strong proponent of free trade, being a nation that widely profits from exporting goods of low cost to other countries. China currently has 13 Free trade arrangements and many more other bilateral agreements. In response to the USA's movement towards protectionism, China might also change their policies. The International Trade Administration of the USA implemented an anti-dumping tariff on tissue products from China as they felt that it was threatening their domestic markets. China retaliated with an equal impactful tariff on US products. There are some economists who are concerned about the possibility of a trade war between these two economic superpowers.

China is known as one of the world's major global superpowers, and its president Xi Jinping has ambitious plans to foster and develop this economic power, not only to further national interest but to cultivate soft power that is unmissable in the current global poetical landscape. China's investment in Africa and Belt and Road Initiative will not only greatly shift the dynamics in the global economy, but will also possibly be the rise of new trade free arrangements or the establishment of new tariffs.

European Union (EU)

The EU is currently the worlds largest trader and accounts for 20% of the world's trade. The EU is a single market which holds free trade as one of its principles, allowing member states to profit from free trade. The EU is a firm believer that trade can be used to develop less economically developed countries economies through allowing lower tariffs to support small businesses and create jobs. Despite this, the EU still has substantially high agricultural tariffs, which is especially damaging towards less economically developed countries as agriculture is generally their largest export.

United Kingdom (UK)

The UK, having been part of the EU, enjoyed free trade and a single market in which they could trade without barriers such as protectionism. With the recent "Brexit", Britain may have to withdraw from the single market, and their policies on protectionism might change. The UK is currently the worst performer of the Group of 7 and is experiencing inflation and a drop in the value of the pound as a direct result of Brexit. The UK might change its protectionist policies to defend its economy.

World Trade Organisation (WTO)

The WTO acts as a forum where trade disputes can be solved, and free trade arrangements can be supervised. The WTO sets ground rules and guild lines for international trade and aims to liberalize trade, encouraging free trade arrangements and has sponsored numerous initiatives to lower customs duties since the 1950s.

Association of Southeast Asian Nations (ASEAN)

The ASEAN Free Trade Areas (AFTA) was virtually been established and is a major free trade arrangement in competition with the EU single market and the UMSCA. ASEAN has made significant attempts to lower intra-regional tariffs through its Common Effective Preferential Tarif (CEPT) Most of the products in the CEPT's Inclusion list of the ASEAN-6 (Brunei Darussalam, Indonesia, Malaysia, The Philippines, Singapore and Thailand) have been brought down to the 0-5% tariff range.

ASEAN's major trade markets include the United States, the EU and Japan. With the implementation of the AFTA, intra-regional trade is expected to increase, further underlining the trend of decrease in trade with the US, India, and Canada.

Timeline of Events

Date	Description of Event
1944	The World Bank is established.
1946	The Bretton Woods system is introduced between 44 nations as an incentive to liberalize trade after World War II.
1948	The General Agreement on Tariffs and Trade (GATT) between 24 countries comes into force.
1957	Treaty of Rome established a common market between European countries, a step towards the current single market and liberalization of the European economy.
1994	North American Free Trade Arrangement (NAFTA) takes effect
1995	World Trade Organization was founded as an intentional forum that aims to settle disputes and lay down ground rules.
2002	The EU currency is launched, establishing a single market.
2016	The UK steps out of the EU, which might mean that they will withdraw from its the single market.
2017	The USA withdraws from Trans-Pacific Partnership under Trump
2018	The USA imposed a series of tariffs to protect their industries, mainly from Chinese exports
October 2018	The USMCA (NAFTA 2.0) is formally agreed to by all parties

Previous attempts to solve the issue

The issue of protectionism in international trade is a widely discussed topic with many variables and pros and cons to consider. Many treaties and agreements have come into effect which aims to improve free trade and limit protectionist policies. However, it is nearly impossible to evaluate their effectiveness as there are so many variables to consider and no single attempt can be proven definitively to have improved free trade. Free trade arrangements are in some sense, a solution to international tariffs, however, they do not come without their own disadvantages are previously outlined.

One can confirm that there are examples of free trade such as the European Single market that have proven to be effective in stimulating the global market and developing economies. Measures to combat high tariffs of individual countries have been put in place and there are certain ground rules as established by the WTO, however, there is still an issue with protectionism. There are no concrete measures in place to prevent a protectionist "arms race" and with Donald Trump as the president of the USA who has repeatedly expressed his desire for an increase in tariffs and protectionist policies, this might be a rising threat to the global market.

The Future

One thing most G20 member states can agree upon is that a so-called tariff "arms race" or a trade war need to be prevented at all cost. Recently, China and the USA have been imposing tariffs on each other's imports. This started in 2018 when the US imposed tariffs on metals which had previously been imported from China due to threats of national security. This highlights the strong link between economic and military power, as the two primary forms of hard power in global politics. Immediately, China retaliated by imposing their own tariffs, which would hit just as hard on the US agricultural industry. Albeit the aggerate amount of trade affected being moderate relative to the size of these superpowers economies, this trade dispute is of great significance to the global economy considering it is the most extreme case of protectionism since the 1930s. This has raised concerns about a possible trade war which would have major repercussions for the global economy, particularly trading partners of China and the USA.

Figure 1: Simonds, David. "Trade War - USA/China." Manufacturer's Monthly, The Economist, www.manmonthly.com.au/features/export-council-australia-challenges-rise-protectionism/.

Another uncertainty of the future is the development of new free trade agreements, especially surrounding Brexit and the UK leaving the EU's single market. The UK will be in a vulnerable position because, due to a lack of necessity because of its membership to the EU, it has not established many trade arrangements outside of the EU single market. Though free trade arrangements are becoming increasingly more popular, when taking the USMCA agreement, we can see that the brokering of such agreements is a very lengthy and bureaucratic process.

With the rise of free trade arrangements in trading bloc's , the exclusiveness of trading bloc's is further defined. Intra-regional trade is made easier and facilitated through these agreements, locally centralizing economic power. This starkly contrasts China's economic policy which is one of the global economic interconnectedness. This phenomenon will likely create a dichotomic effect which might further pave a path towards a potential trade "arms race".

Important Decisions a Resolution Must Take

Several important decisions on the topic of international trade and protectionism must be established with the recent turmoil and controversy surrounding tariffs. The attitude the G20 adopts on the matter needs to be concretely established as to lay a foundation for possible solutions to the problem. This could potentially be done in reference to the WTO who specializes in trade disputes and issues surrounding tariffs.

Secondly, the degree to which both states and non-member states can interfere in bilateral trade disputes also needs to be discussed. In our interconnected and global economy, bilateral issues are no longer strictly bilateral and there are many stakeholders in each conflict, especially within regions. Do organizations such as the WTO have the legitimacy to regulate the global economy? Does regulating tariffs to preserve the global economy infringe on national sovereignty? These are some questions to consider in regard to the possible role the G20 can assume in resolving this issue.

Some less explicit aspects also need to be tackled such as corruption, transparency so that a trust is established between member states. Trust is fundamentally what facilitates discussions on an issue so complex and volatile. The G20 needs to decide how it will prioritize the integration of trade blocs while maintaining competition between member states to create a healthy and flourishing global economy.

Another issue of great significance is how we encourage free trade without creating polarization and a dichotomic rift between different trade blocs. Furthermore, how do we tackle countries such as the UK who are without solid trade agreements or emerging economies who are having difficulty accessing global markets? How do we ensure that LEDCs are not excluded from free trade arrangements? The overarching question is how we ensure harmony in our global economy and avoid a trade war or a protectionism "arms race".

Further Reading

I. This figure indicates how well your country "enables trade: according to the World Economic Forum: http://reports.weforum.org/global-enabling-trade-report-2016/enabling-trade-rankings/#series=ETI

II. A summary of the G20's protectionist policies as a whole:
http://unctad.org/en/PublicationsLibrary/unctad_oecd2014d12_summary_en.pdf

III. Statements of individuals countries on the subject of protectionism in general:
https://www.un.org/press/en/2013/gaef3376.doc.htm

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