

# Protectionism and Populism: The Effect of New Politics on the Global Economy

## Key Highlights

- Populist ideology has been gathering tremendous support around the world, which has given rise to protectionism.
- The US-China trade war and Brexit are the result of populist forces gaining support over the past few years.
- The EU also witnessed a rise in populism, as right-wing populist parties gained higher vote share and Parliamentary seats in their respective countries.
- The rise in populism and protectionism weighed on the global economic growth and also hampered trade around the world.
- Emerging economies could gain from the trade diversion effects caused by trade wars, but could also be at the receiving end of the impact of trade wars, given their reliance on foreign demand.

The developments in the US and Europe, including the US-China trade dispute, Brexit uncertainty and the ongoing domestic issues across the European political spectrum, have impacted global trade over the past few years. The kernel of all these developments has been the growing populism, that has resultantly led to a rise in protectionist policies. While the developed economies are already bearing the brunt of emergence of these ideologies, the developing economies, where free trade is still the prevalent way, are getting adversely affected too. The reason for the emergence of these ideologies is the perspective that globalization and free trade are benefiting a few, at the expense of many. And although supporters of populist ideologies try to justify protectionist measures on the grounds of fairer trade, the impact of such measures have weighed on the global economy and flow of trade. Additionally, protectionism has also been impacting the export-oriented economies, who are dependent on the global demand to conduct trade.

## Donald Trump and his America First Policy

Two most important issues that have been making headlines over the past two years are trade disputes, especially the one between the US and China, and Brexit, both of which are the results of growing protectionism and populism. According to a recent survey by Ipsos<sup>1</sup>, most citizens across the world would prefer a leadership that lean toward citizen-first views, indicating a widespread populist sentiment.

The election of Donald Trump as the President of the US was one of the events that brought the discussion about protectionism and populism to the forefront. Donald Trump's election campaign was fraught with populist promises, such as "America First Policy", which touched upon the cultural as well as the economic aspects of populism. The protectionist threats made by the Trump administration in 2017 were followed by concrete actions which included the US opting out of the Trans-Pacific Partnership (TPP) deal, renegotiating the NAFTA Agreement, levying tariffs on the imports of steel and aluminium, and on the goods imported from China. The trade conflict between the US and China culminated into full blown trade war that adversely affected not just their domestic economies, but also the global economy. According to the US Congressional Budget Office, the changes made in the domestic and foreign trade policies by the Trump administration since January 2018 would reduce inflation-adjusted US GDP by 0.3%<sup>2</sup> from what it could be otherwise by 2020. Additionally, the policies would also negatively impact real income for the average US household by 0.4%, or \$580<sup>2</sup> by the end of this year.

While the US and China have recently entered into partial trade agreement to put an end to their 2-year long trade dispute, most tariffs on billions of dollars' worth of Chinese imports still remain in place. Moreover, the decision to remove tariffs would likely be taken up during the Phase 2 of the trade deal, after the 2020 US President Elections. The elections in November later this year will be a notable event for 2020, with the incumbent, Donald Trump, attempting to be re-elected as the President after a tumultuous four years at the helm. We believe that the likelihood of Donald Trump getting re-elected as the US President is high, following recent improvement in approval rating and the healthy performance of the US economy. If Donald Trump is re-elected as the President, we may see more populist policies that would play a key role to drive the economic growth and to possibly offset the impact of protectionist policies. Although populist policies usually prove to be advantageous for an economy in the short term, we believe that such policies could create debt burden given the increase in public spending, and the protectionist measures such as tariffs on imports, protecting domestic industries may weigh on growth in the long term.

The US has been making headlines due to its trade dispute with China, however, it is not the only country that has been witnessing populist policies and the implementation of protectionist measures. The UK voted to leave the EU in 2016, signifying the growing populism across the Atlantic. Even in Europe, the populist agenda, including immigration and protecting the domestic industries, has gained momentum.

### Brexit: Another Major Instance of Growing Populism

In line with the US pulling out from its commitments around the world to focus on the “America First” policy, the UK also withdrew from the EU to “take back control”. The Brexit referendum, held in June 2016, is considered as the herald of the growing populism in the western Europe. The UK had decided to leave the bloc, largely over concerns related to immigration from the EU nations, that drove more than 50% of the region’s populace to vote in favour of Brexit. Additionally, the Brexit referendum was advisory in nature, and not binding, giving the UK an option to abort leaving the bloc. However, the political leadership, claiming to honour the will of the people of the UK, chose to proceed with Brexit, despite believing that staying in the EU is in the best interest of the UK. While the Brexit referendum result, in our opinion, gave additional weaponry to far-right populist parties to argue in favour of exiting the EU, it also made clear to the political parties that opposing the public opinion could be seen as a political disaster. This, in our opinion, points towards the rising populist tendency, as the UK government acceded to the majority opinion, despite knowing the economic ramifications of Brexit.

A period of uncertainty had set in following the referendum, as the British Parliament could not form a majority in favour of a withdrawal deal, leading to an adverse impact on the UK economy. It took more than three years for the UK to finally agree to a withdrawal agreement in their Parliament, prolonging uncertainty for business, consumers and investors alike. The UK has finally exited the EU and has entered a transition period, to decide on its trade relationship with the EU, diminishing to some extent, the protracted uncertainty related to Brexit.

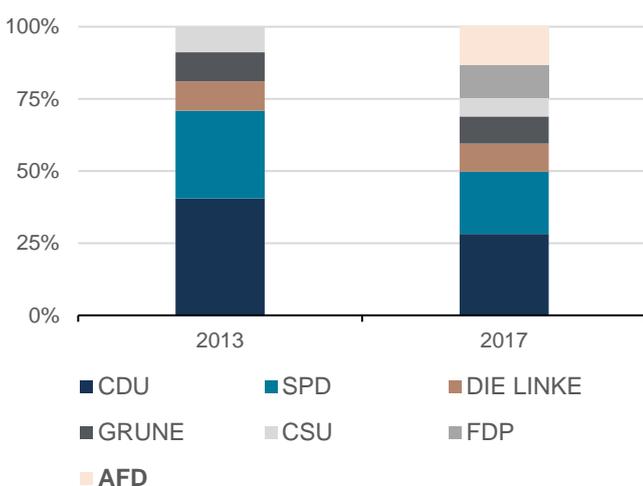
According to Bloomberg Economics, Brexit has cost the economy nearly £130 billion<sup>3</sup> (\$170 billion) since the 2016 referendum, and the number is expected to go up by the time the UK fully leaves the EU. Since Brexit means both parties will pull out of their frictionless economic relationship, there will be economic consequences to be faced by both sides. Following Brexit, trade barriers, capital flows, and labour mobility will impact economic output and employment not only in the UK but also in EU nations. Additionally, we believe that the Brexit vote may fuel Euro-sceptic notions among EU nations. If anti-EU political parties gain enough ground, they could force an anti-EU vote in their nations and could threaten the integrity of the EU.

### Rising Populism in Europe and Calls to Protect Domestic Industries

The EU witnessed a rise in populist forces following the global financial crisis of 2009. The economic difficulties faced by many EU nations alongside issues related to migration and terrorism have acted as the catalyst for growing nationalistic tendency within many EU nations. The calls to protect domestic economies and the rising nationalism in major EU countries, led to a rise in political parties with populist ideology. Currently, the major concern for the EU is the increase in populist representation in the national as well as the European Parliament, as many countries witnessed a rise in the vote share of populist political parties in the national elections or EU Parliamentary elections.

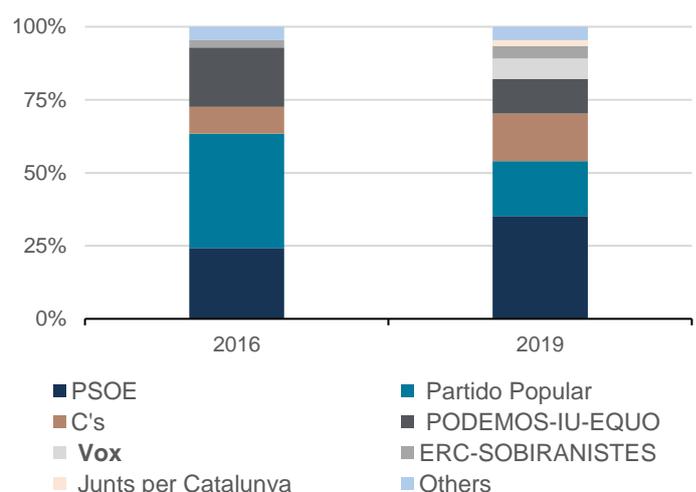
### Increase in the Presence of Major Populist Parties in Germany and Spain (Parliamentary Seats)

Germany Election Results



Source: German Federal Returning Officer <sup>4,5</sup>, major populist parties highlighted in bold

Spain Elections Results



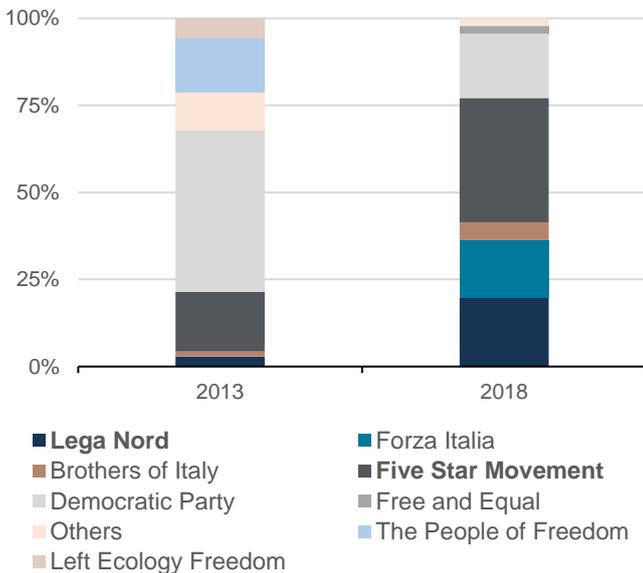
Source: electionresults.eu <sup>6,7</sup>, major populist parties highlighted in bold

In Germany, a populist party Alternative for Deutschland (AFD) entered the Parliament for the first time with a significant vote share in the national election, making it the third largest party in the country. Meanwhile, in Italy, two populist political parties – the Lega Nord and the Five Star Movement – formed a coalition government following the national election. Similarly, populist parties are gaining support

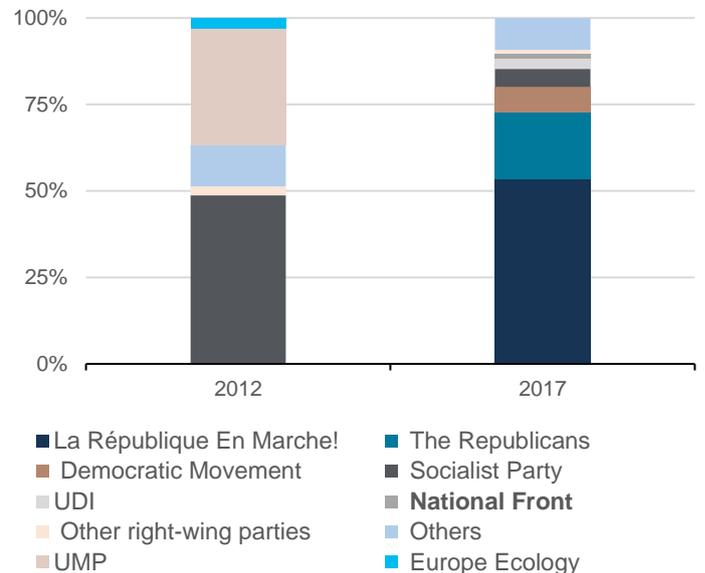
across many other EU nations, such as National Front's gaining popularity in France, Vox's ascend from no-seat share to around 7% seat share in the Spanish Parliament, suggesting an increasing support for nationalistic dialogue and right-wing populism.

### Increase in the Presence of Major Populist Parties in Italy and France (Parliamentary Seats)

Italy Election Results



France Election Results



Source: [electionresults.eu](http://electionresults.eu) <sup>8,9</sup>, major populist parties highlighted in bold

Source: [electionresults.eu](http://electionresults.eu) <sup>10,11</sup>, major populist parties highlighted in bold

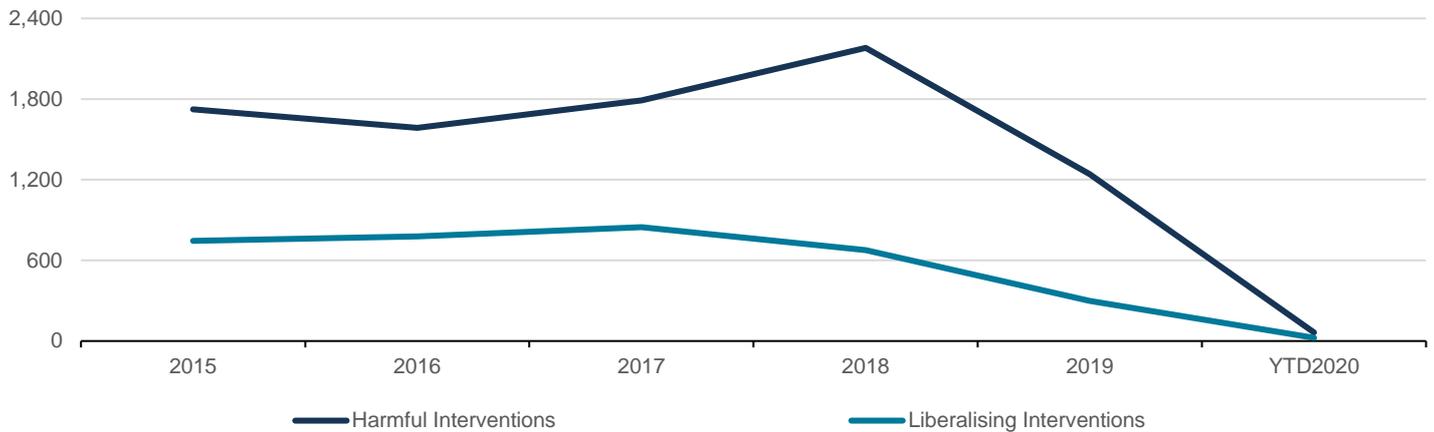
Even the European Parliament election of May 2019 witnessed right-wing and nationalist parties gaining a sizeable number of seats in the European Parliament. And while the European Parliament is still controlled by a clear majority of pro-European forces, it will probably become difficult to make decisions or to reach unanimity. Moreover, there are fears that Brexit would invoke the idea of holding a membership referendum in the EU member countries. In our opinion, if the populist forces continue to gain political ground in the future national or European elections, it can heavily affect the working of the EU, or can even threaten the existence of the EU.

Apart from the internal political issues, the bloc has also been facing accusations of relying on trade barriers and non-trade barriers to protect its domestic producers from other countries. Although sometimes there are reasonable explanations for barriers, such as protecting the environment, they do have an impact on trade and could be a form of disguised protection for domestic entities, often at the expense of competitive foreign industries from developing countries. The EU's proposed policy of phasing out palm oil, which is majorly imported from Indonesia and Malaysia, or the European Commission 'safeguard clause' to protect Italian rice from Cambodian exporters are some of the cases that highlight the EU's protectionist tendency. Additionally, Germany and France recently took a hard-line approach to protect their domestic industries by urging for the creation of European "Industrial Champions" that could respond to the fierce competition from US and Chinese companies. All these cases suggest that the EU's protectionist stance is undermining open markets and free trade, which support competition that gives consumers fair prices and access to better commodities.

### World Trade Suffered in the Protectionist Environment

In our opinion, the global trade and the economy is adversely affected in a protectionist environment. Such economic environment could be seen as a reversal of globalisation, that is putting far more restrictions on global trade and free labour mobility. Over the past two years, the world has witnessed a notable jump in hurdles to free trade practices, following the restrictive and retaliatory trade policies adopted by the US, the EU and their trading partners. According to Global Trade Alert (GTA) Database, the number of new measures announced that are detrimental towards free trade have increased significantly in the past two years. Additionally, according to GTA, the number of trade distortionary measures implemented between last G20 meet (in December 01, 2018) to April 15, 2019 (before escalation of US-China trade war in May 2019) have implicated over around \$1.15 trillion<sup>12</sup> of international trade. GTA stated that the US-China trade garnered much of the attention, but other countries, including non-G20 nations, have also resorted to trade distorting tactics. The data suggests that increase in protectionism has been substantial across the globe post last G20 Summit, which has been adversely affecting global trade.

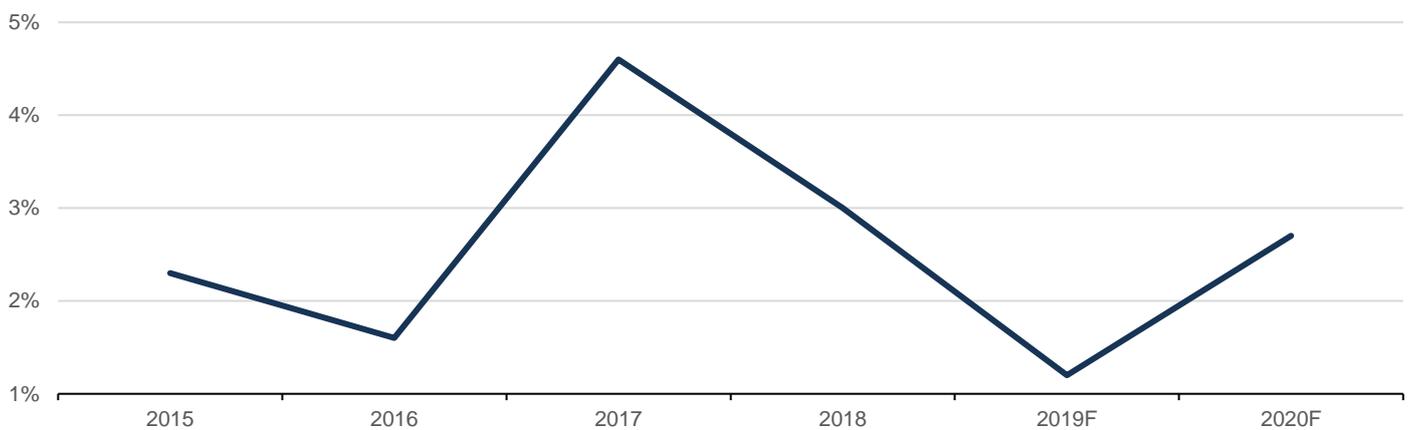
The Number of New Interventions to Trade Activity Rose in 2018



Source: Global Trade Alert <sup>13</sup>

According to the 2019 Statistical Review of World Trade Organization (WTO), global merchandise trade volume increased slower than expected in 2018, on the back of growing trade tensions and economic uncertainty. The WTO indicated that global trade would continue to face headwinds in 2020 and estimated merchandise trade volume growth to decline to 1.2%<sup>14</sup> (previously estimated 2.6%) in 2019 and 2.7% (previously estimated 3.0%) in 2020. The expectation that trade growth will rebound to 2.7% in 2020 is based on the assumption of easing trade concerns. Similarly, the International Monetary Fund (IMF) has repeatedly downgraded its global trade volume growth expectations and suggested that weaker trade prospects are likely to create headwinds for investment.

Global Merchandise Trade Volume Growth Witnessed Downturn in the Past Two Years



Source: WTO <sup>14</sup>

The impact of softening of trade and investment has been weighing on the global economy. The IMF downgraded its economic growth forecast multiple times over the past year. In its latest projections in January 2020, the IMF downgraded its global GDP growth forecast from 3.4% to 3.3%<sup>15</sup> for 2020. Further, according to Bloomberg Economics report, uncertainty related to trade could cut global economic growth by 0.6%<sup>16</sup> in 2021, compared to a no-trade-war scenario. The report indicates that the impact is equivalent of \$585 billion<sup>16</sup> shaved off the IMF's projected global GDP of \$97 trillion in 2021.

We believe that global trade and growth would become weaker in such a protectionist environment as barriers would result in less opportunities. Further, many countries would be deprived of the advantages of free and open markets such as economies of scale, quality of production that thrives on competition, transfer of technology etc. However, with the recent signing of a partial trade agreement between the US and China and the willingness of the UK and the EU to sign a freest trade agreement possible, the outlook for global appears to be bright, compared to how it seemed last year. Moreover, the uncertainty related to trade has diminished to a certain extent, as the possibility of an escalation in US-China trade war and a disorderly Brexit now seem low, which is likely have a positive impact on the global economic growth going forward.

Protectionism: An Opportunity for Emerging Markets?

The impact of populism and protectionism would also be felt in the emerging markets, and particularly in regions dependent on international trade such as Asia and Middle East. Protectionism could hamper foreign demand for local commodities, adversely affecting nations that rely on exports. To cite an example, global agencies had downgraded their oil demand growth forecast multiple times owing

to ongoing trade dispute between the US and China. Oil demand from China makes up a significant share in the global oil demand and a decline in China's oil consumption could have an adverse impact on oil exporting nations.

On the other hand, trade wars disrupt global supply chains and create trade diversions. The emerging markets can gain from the opportunities created from it. According to a report by Asian Development Bank (ADB), Asia's emerging economies have been gaining significantly from the US-China trade dispute, with exports from Asian nations to the US increasing by 10%<sup>17</sup> on an annual basis in the first half of 2019, despite a 12% decline in exports from China. The report highlighted that Bangladesh gained significant market share in textiles and Vietnam in electronics, as a result of trade diversion due to the US-China trade war, leading to a substantial rise in their exports to the US. Additionally, as a result of the trade war, many companies have been considering shifting their manufacturing activities out of China and into South-Asian nations, which could prove advantageous to South-Asian countries in terms of inflow of foreign investments.

### **Protectionism and Populism: A Lasting Theme**

In our opinion, global economy would broadly benefit more from a free trade environment compared to a protectionist trade environment. Issues such as low economic growth, stagnant incomes, rising inequality, immigration and a perception that the political system is not delivering are some of the themes that are likely to keep populism afloat in the coming years. Therefore, investors and businesses should think of populism as a lasting theme. The current surge in populism and the resultant protectionist tactics is already shaping the global macroeconomic outlook, and given the current political and macroeconomic situation, we are likely to witness more populist initiatives and protectionist measures around the world going forward.