

Long term impact of protectionism

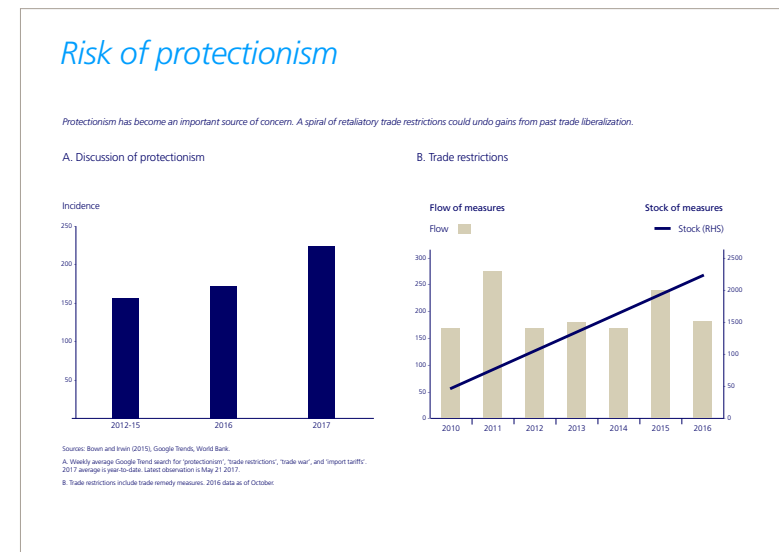
Backlash against free trade and globalization could lead to slower global growth





Long term impact of protectionism Backlash against free trade and globalization could lead to slower global growth

Since the 2008 financial crisis, growth in trade openness has stagnated and protectionist measures have increased.



Source: World Bank, Global Economic Prospects, June 2017, p.26
<https://openknowledge.worldbank.org/bitstream/handle/10986/26800/9781464810244.pdf>

01
Federica Cocco, 'Most US Manufacturing Jobs Lost to Technology, Not Trade,' Financial Times, December 2, 2016, <https://www.ft.com/content/dec677c0-b7e6-11e6-ba85-95d1533d9a62>.

02
<http://www.businessinsider.com/trump-steel-tariff-china-germany-japan-global-recession-2017-6>.

03
Dale C. Copeland, Economic Interdependence and War (Princeton, NJ: Princeton University Press, 2014).

Recent years have seen a political backlash against free trade and globalization in wealthy countries, along with a slowdown in export trade. While high-income states have been among the biggest beneficiaries from globalization, there is growing evidence of unequal benefits within countries. Many voters in the United States and Europe blame free-trade agreements for the loss of well-paying, middle-class jobs¹.

Brexit and President Donald Trump's victory partly stem from this growing anti-globalism mood. Since his election, Trump has fulfilled his electoral pledge to remove the United States from the Trans-Pacific Partnership (TPP) agreement, has called for a renegotiated North American Free Trade Agreement (NAFTA) to reduce the US trade deficit and is reportedly considering a 20% tariff on imports of steel and possibly other goods². In the past, protectionism has led to more instability, including conflicts between countries³. Other factors, such as Chinese curbs on foreign investment, are raising business concerns about China's commitment to openness. Growing China-US military tensions over the South China Sea or differences over how to persuade North Korea to end its nuclear weapons program could spill over to accelerate the trend toward more trade and investment restrictions.

Donald Trump's administration has put its main program for bolstering economic relations with China on ice as it complains about the two countries' swollen trade imbalance, and says Beijing's efforts to liberalise its economy have gone into reverse. David Malpass, a top economic diplomat for the administration, said in an interview with the Financial Times on Thursday that the Comprehensive Economic Dialogue with Beijing is 'stalled' and that there are no plans to revive talks. The decision comes after the dialogue between the two countries in July ended without any tangible progress.

The White House is taking an increasingly confrontational approach in its economic relations, including by opposing China's bid for recognition as a 'market economy' in the World Trade Organization.

Protectionism: scenario variants



	Base Case 2016	Base Case 2018	Base Case 2035	Globalism Resurgence	Protectionist Victory
GDP billion USD	82,000	87,200	141,400	25,900	-18,000
Extreme Poverty (less than \$1.90/day) million people	950	830	710	-22	33
Middle Class (\$10+/day) million people	2,480	2,890	3,950	68	-54
Instability number of countries	-	-	-	0	64

Source: Our world transformed: Geopolitical shocks and risks, 2017



Note: GDP is reported as the cumulative difference between Base Case and scenario variant (in billions of US dollars); Extreme Poverty measures those living on less than \$1.90 per day (in millions of people); Middle Class includes those living on more than \$10 per day (in millions of people); Instability is reported as the number of countries experiencing higher levels of instability relative to the Base Case.

The Base Case is our "business as usual" scenario. Global Resurgence is a more optimistic one in which there is a renewed emphasis on global trade while another that is called 'Protectionist Victory' examines the impacts of more protectionism.

Major geopolitical implications

Greater protectionism leading to slower global growth would hurt all countries, but developing ones are most vulnerable.

We modeled several scenarios, including ones which saw a renewed emphasis on global trade which we called '*Globalism Resurgence*' and another on more protectionism or '*Protectionist Victory*.' Over an almost twenty years out to 2035, the difference between the scenarios in terms of global GDP is an overall \$44 trillion. Low-income countries are particularly hard hit, suffering 8 percent drop in GDP while high-income countries would see a 5 percent drop.

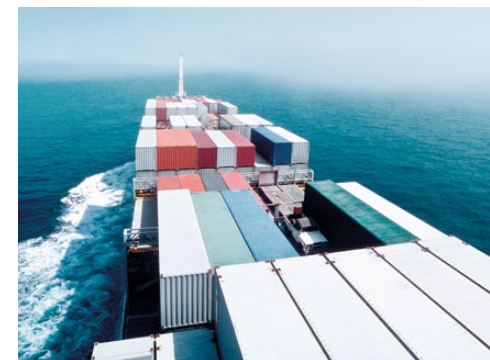
The foregone gains seen in Protectionist Victory, as compared to Globalism Resurgence, are felt more strongly in countries that have not yet been able to take full advantage of the global economy. Africa and Central America, for example, appear the most sensitive to long-term protectionist policies.

With some European countries, such as those of Southern Europe, already forecast to see lower levels of growth over the coming decades in the Base Case, an increase in global protectionism on the scale simulated in Protectionist Victory could translate into an economic slowdown.

The difference in the number of people living on \$10 or more per day between Globalism Resurgence and Protectionist Victory would be more than one hundred and twenty million people by 2035, or roughly the size of Mexico's or Japan's population today.

While the rough proportion of middle- and upper-class population in high-income economies remains largely the same across these scenarios, increased global protectionism undermines the growth of a middle class in the rest of the world.

The probability of violent domestic conflict increases in sixty-three countries in Protectionist Victory. The growing violent conflict is driven by stalling human development and government capacity in Protectionist Victory. India, Egypt, the Philippines, and Thailand are among those that experience the greatest increase in risk of instability under Protectionist Victory.



[View Protectionist victory in G20 countries](#)

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\$10

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Source: Our world transformed: Geopolitical shocks and risks, 2017

Worsening in China-US ties could create a risk of large scale protectionism

If mutual tariffs were established and stayed in place, because of growing hostilities or a mutual trade conflict, separate spheres of Chinese and US economic activity would likely be created, rewiring current trade networks and significantly disrupting supply chains.

China has one of the highest participation rates in global value chains. With the rise in China's economic importance, many countries that had been closely aligned with Western countries are increasingly reliant on Chinese trade.

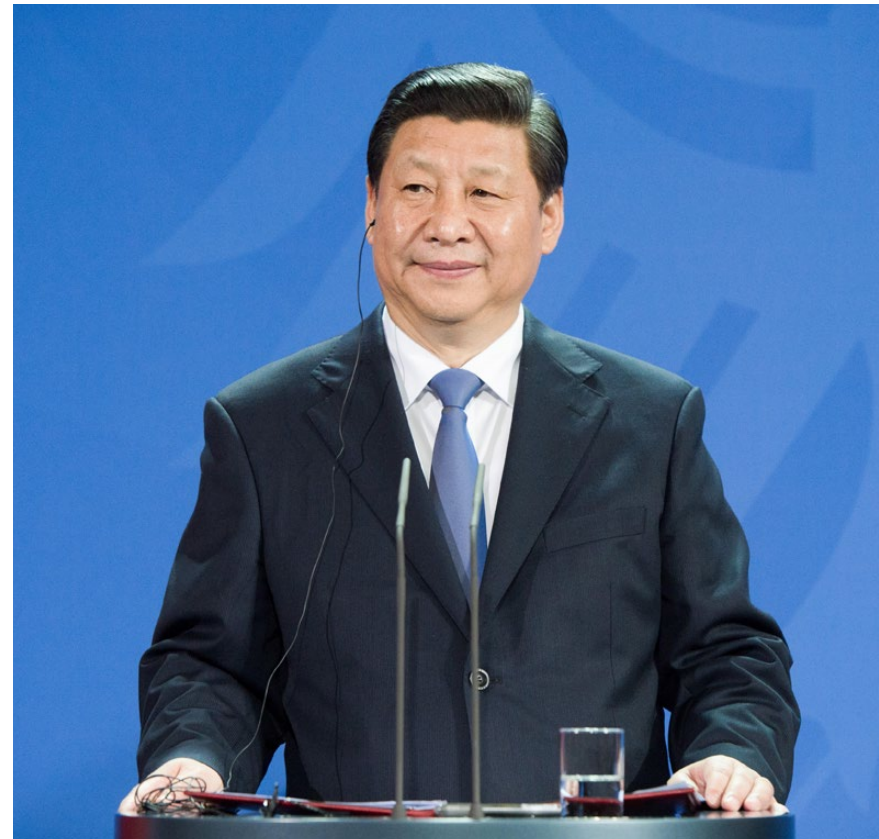
Over fifteen to twenty years, separate China-US spheres of economic activity could result in a \$95 trillion cumulative reduction in global exports. Foreign-investment growth would slow globally, but the United States and China would probably increase foreign aid to allies and partners to shore up ties.

The reduced trade would put the world on a lower economic growth trajectory. Global GDP would be reduced by a cumulative \$35 trillion, leading to twenty million additional people living in extreme poverty, forty-five million additional people living on less than \$3.10 per day.

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Insights from the Zurich Risk Room



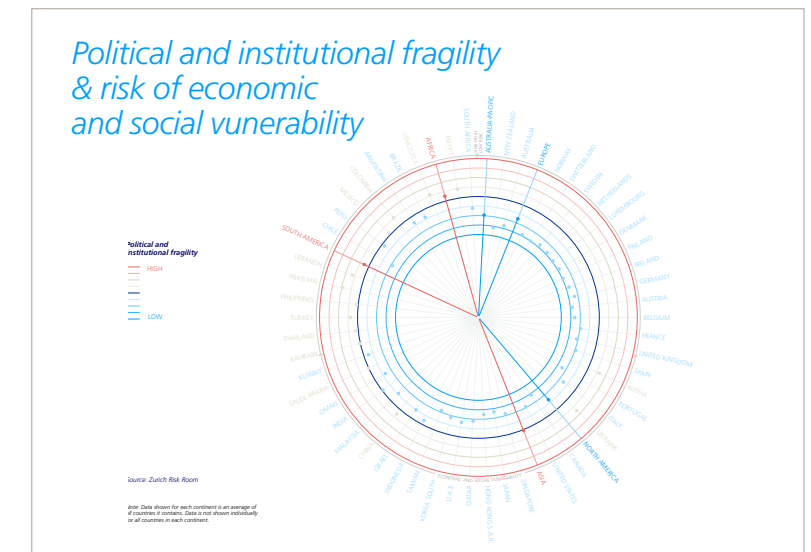
We used the Zurich Risk Room – a global risk analysis tool, designed to help illustrate the impact of multivariate risks on individual countries and regions – to model a scenario on the risk of protectionism.

We chose to contrast the level of economic risk facing G7 countries and Switzerland compared with BRICS (Brazil, Russia, India, China and South Africa), highlighting the countries that are better positioned to exploit protectionism changes.

Although the chart indicates that most G7 countries are in a better position to fend off protectionism, Brexit and President Trump's election show that a powerful popular backlash against globalization has grown up even in rich and economically stable countries. While Chinese President Xi-Jinping has positioned himself as a defender of globalization, the chart shows that China and other BRICS countries could be vulnerable to protectionist pressures.

With slowing economic growth in the BRICS, the emerging middle classes may feel stymied as their lofty aspirations go unmet. Among all countries, Brazil is the most vulnerable because of a lingering recession and protracted political crisis. The eight factors which we saw influencing the **'Risk of Protectionism'** include Burden of Customs Procedures; Currency Inconvertibility; Non-tariff Barriers to Trade; Trade Tariffs; Trading Across Borders; Burden of Government Regulation; Effect of Taxation on Incentives to Invest and Brain Drain. The risk indicators highlight the free movement of goods, persons, services and capital and relevant laws, regulations and administrative provisions. On the other side are the **'Economic and Political Instability'** factors (as proxied by, for example, employment of working-age population, income inequality, state failure and armed conflict risk) whose absence or presence would decrease or increase economics' ability to manage protectionism risk.

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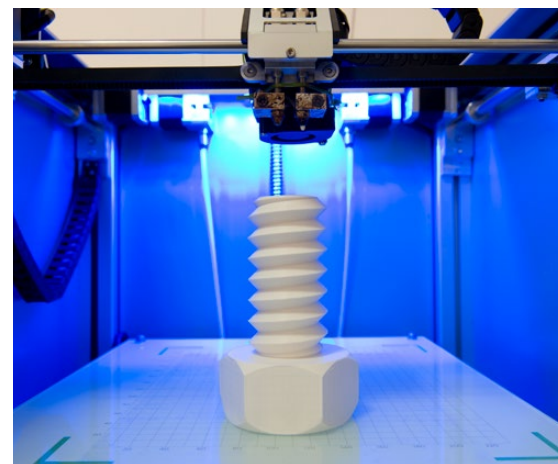
[View the 'Risk of Protectionism' and 'Economic and Political Instability' chart](#)

Ways to mitigate risk

Fundamental challenges to the global economic and political system created by major western powers after World War II are creating highly uncertain environments for companies. Crisis management approaches can help focus on the identification and mitigation of protectionist risks. Many firms benefit from global value chains which can be essential to their very existence. Restructuring supply chains is not a simple task. There may not be a lot of time to restructure supply chains, particularly as governments are likely to react swiftly once any one government enacts trade restrictions.

Companies will need to develop business continuity plans that anticipate having to arrange substitute suppliers and designate alternative manufacturing or retail sites.

New technological innovations such as 3D printing can in some cases allow for more manufacturing in place and, as such, could provide a way for companies with manufacturing needs to lessen dependence on global supply chains.



Countering Supply Chain Disruptions

It is very important for companies with critical supply chains that they understand their exposures to geopolitical actions. Technology can be useful in developing a holistic picture of the critical supply chain.

Companies can adopt a number of mitigation strategies including the purchase of supply chain insurance to protect against supply chain disruptions. In addition, many political risk insurance (PRI) policies cover against import and export embargoes or license cancellations which might be imposed in a trade war or for other reasons.

As supply chains are disrupted, another knock-on effect is the financial impact on both buyers and suppliers along the supply chain. If companies are unable to deliver to their customers due to supply chain disruptions, their own financial health can be jeopardized. Large, unexpected increases in tariffs could increase costs to such a degree that buyers default on contracts.

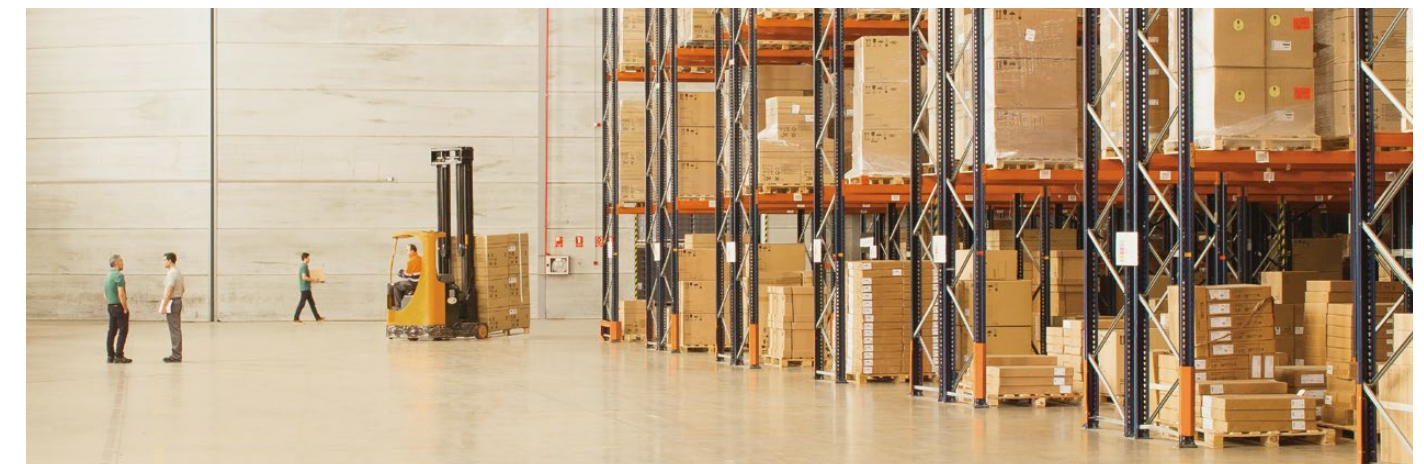
Again, insurance, such as trade credit insurance, can play an important role in mitigating the risk for companies with these types of exposures. Increased protectionism is likely to raise costs for manufacturers in other ways: higher inventory handling costs, alternative sourcing options from higher cost suppliers, transportation delays due to border controls and customs charges.

In export-dependent countries, reduced trade could translate into lower economic growth, higher unemployment and political unrest, leading to higher risks for firms with exposure in these countries. PRI is one solution to cover some of the most catastrophic of these risks, including but not limited to political violence causing damage to assets.

Business associations are already vigorously engaging governments and policymakers on the business consequences of key trade policy changes. It is still unclear how far these efforts can go to influence governments that are under pressure from a groundswell of protectionist and nationalist sentiment. However, the stakes for firms and for entire economies are too high to ignore. An awareness of key industrial clusters within a supply chain is also important as there can be a tendency for human skills to be clustered around a certain location, which may be impacted by geopolitical tensions.

Dealing with unintended consequences

Indeed, setbacks to global trade will likely cause a number of unintended consequences, and government economists will be under pressure to conduct very sophisticated analyses to determine the full impact on their respective economies. Assessing the impact of protectionism on consumers, tax revenue, economic growth, and companies is a massive exercise in itself, but then trying to predict how other governments will respond is an even more daunting exercise. Scenario planning will be a key tool to assess these risks.



Public-Private Partnership

Governments will also need to develop continuity plans, examining the impacts on national security from cutoffs supply chain disruptions or increased costs of imports. Governments and companies should both consider using tools such as bold scenario planning to map the potential second and third order effects resulting from greater protectionism. Governments may not be aware of their dependence on global value chains for their ability to carry out vital government functions. An inventory of ways that key government functions rely on imports could prevent later surprises. As a way to mitigate disruptions, governments could explore strengthening trade relationships with nonrestrictive countries and sometimes this can lead to productivity gains and economies of scale not previously thought. For companies active in global markets, assessing the likely course of events will become ever more difficult, but it is some consolation that there are risk management techniques to help mitigate the potential financial impacts.

Total Risk Profiling® on Protectionism

Approaches from business continuity management, especially scenario planning, can help with the identification and mitigation of risks. A method to achieve this is Total Risk Profiling® (TRP®). It is a structured approach to identifying, assessing and monitoring risks and improvement actions. Embedding Zurich's TRP® methodology can further help ensure a company's risk management culture is consistent and effective.

Scenario-based thinking and decision making
 TRP® is a proven workshop-based risk identification and prioritization method developed by Zurich. Based on the premise that you know your business, operations and markets better than anyone else, TRP® tends to produce the best results when used with a team of professionals who are directly involved and/or have expert knowledge of the scope being analysed.

The facilitator-led team will then develop a risk profile by determining relative ratings (in likelihood/impact terms) of risk scenarios. It uses these risk scenarios to define the underlying issues, breaking them into their components of vulnerability, trigger and consequence.

A 'tolerance boundary' is defined as an expression of appetite for risk and this is used to prioritize risks. Action plans are developed to improve the prioritized risks and bring them within the team's tolerance for risk.

Key features

TRP® is a highly efficient way to optimize the risk/reward balance across your enterprise.

The structure of the TRP® risk identification process provides a sound basis for detailed quantification of more complex risks.

TRP® helps to set the agenda for internal audit or enterprise risk management to monitor risks at or just below the risk tolerance boundary.

The opportunity to define multiple triggers with different consequences helps to identify the true drivers of a risk undertake.

The principles of TRP®, which can be applied in a wide variety of circumstances, represent a tried and tested approach to address these challenges.

Vulnerability identification and assessment

Vulnerability catalog



Risk mapping/ Risk tolerance boundary

Risk profile



Risk reduction/ Risk improvement advice

Risk improvement catalog

Action plans are developed to improve the prioritized risks and bring them within the team's tolerance for risk.

TRP® on Protectionism – Vulnerability identification

Potential key questions to identify the vulnerabilities related to the protectionism scenario, to develop risk scenarios, quantify financial severity and assess probability can be as follows:

Characteristics of your business/organization

- Based on your geographical spread and/or concentration, how much of your turnover will be vulnerable to various protectionism scenarios?
- How much are your various suppliers (Tier 1, 2 or even 3) affected? How well known are your bottleneck suppliers, and how easy will it be to substitute them and at which cost?
- How dependent are you of key industrial clusters that might be affected by protectionist measures that result in a complete cut off such as a whole supplier base?
- As a typical export business, how difficult will it be to defend your market share in key markets that are affected by protectionism?

Management style and strategy

- How vulnerable are you to license and contract term cancellations?
- Could protectionist measures affect your creditworthiness or the ones of your suppliers and customers?
- Could embargoes create compliance issues with laws and regulations?

External factors

- As supply chains become disrupted, how likely is it that 2nd order knock-on effects to your buyers and suppliers could default?
- How likely is it that an unexpected large increase in tariffs will increase costs to such a degree that your buyers default on contracts?
- What is the likelihood that 3rd order effects, like lower economic growth resulting into political violence, will result from protectionism in one of your key production countries, supplier base or markets?

Operations and procedures

- How likely could an increased protectionism raise costs for manufacturing, like higher inventory handling costs, alternative source options from higher cost suppliers, transportations costs/delays due to border controls and customs charges?
- How well established and tested are your contingency plans?
- Have key human skills also been clustered around a certain geographic location, which may be impacted by geopolitical tensions?
- How big is the potential that embargoes affect the reliability of your key production facilities?

Timing and availability

- How big is the potential that embargoes affect the supply of raw material or components to key production facilities?
- How resilient are you in terms of inflation, interest, or currency exchange rate fluctuation in your markets?





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