Genoa Model United Nations Affiliated with

Economic and Financial Committee (ECOFIN)

Topic 2: Tax-driven economic retaliation in power dynamics

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1. Definition of key terms

Retaliation: in the field of economics and international trade, actions taken by one country or group in response to trade barriers or unfair trade practices imposed by another country or group. These actions are usually intended to penalize the parties responsible for the initial trade barriers and aim to restore fair trade practices or protect the retaliating country's economic interests.

Retaliatory Tariffs: taxes imposed by a government on imported goods in response to trade barriers or tariffs set by another country. Such tariffs are typically used as a means to protect domestic industries from unfair competition. However, they can escalate trade tensions between countries, leading to a cycle of retaliation that affects international trade dynamics.

Trade War: a situation where countries impose tariffs or other trade barriers against each other in retaliation, leading to escalating economic conflicts.

Negotiation: the process of discussing issues with another party to reach an agreement, or the discussions themselves.

Mediation: the process of engaging a neutral party to facilitate discussions between two groups or individuals in disagreement to help them reach an agreement or find a solution to their conflict.

2. Introduction

Retaliatory tariffs can significantly strain international relations by creating an environment of distrust and hostility between countries. When one country imposes tariffs in response to another's trade actions, it often triggers a cycle of retaliation that escalates tensions. This back-and-forth exchange can result in a breakdown of negotiations and cooperation, impacting not only trade but also diplomatic relations and economic stability.

3. Background information

To mitigate the negative impacts of retaliation, countries can employ mechanisms such as negotiation, mediation, and adjudication through international bodies like the World Trade Organization (WTO). These methods aim to resolve disputes through dialogue and arbitration, promoting fair trade practices and maintaining economic stability. Trade agreements and treaties often include dispute resolution clauses that provide structured methods for resolving conflicts without resorting to retaliatory measures.

A historical example of such tensions is the trade conflict between the United States and China. In recent years, the U.S. imposed tariffs on Chinese goods, citing unfair trade practices and intellectual property theft. China responded by imposing its own tariffs on American products. This tit-for-tat escalation resulted in a significant trade war, affecting global supply chains, market stability, and causing widespread economic uncertainty.

While generally undesirable due to the broader economic disruptions they cause, retaliatory measures can sometimes be justified as a means of enforcing fair trade practices or protecting domestic industries from unfair competition. For example:

- **Dumping**: If a country sells products at unfairly low prices to undercut competitors, retaliatory tariffs can level the playing field and protect domestic producers.
- **Bargaining Tool**: Retaliation can serve as a pressure mechanism, encouraging the offending country to negotiate and remove unfair trade barriers or practices.

However, the effectiveness and justification of retaliation must be carefully weighed against the potential economic damage it could cause.

Long-term Effects of Retaliatory Trade Wars

Prolonged retaliatory trade wars can lead to several adverse effects:

- Strained diplomatic relations and a breakdown in international cooperation.
- Long-term distortions in global trade patterns as businesses and countries adjust to new trade barriers.
- Increased costs for consumers and businesses due to higher prices and disrupted supply chains.
- Potential slowdowns in economic growth as trade volumes decrease and the efficiency gains from free trade are lost.

To mitigate these effects, it is crucial for countries to seek diplomatic solutions and work collaboratively toward fair and equitable trade practices.

4. Major countries involved

China

China has played a significant role in tax-driven economic retaliation within global power dynamics, particularly in its trading relationships with countries such as the United States. For example, during the US-China trade war of 2018, both nations imposed tariffs on each other's goods. This tit-for-tat strategy was a way for China to counter US actions and protect its own economy. As part of its approach, China targeted key products in US industries, aiming not only to safeguard its domestic industries but also to pressure the US into reconsidering its strategy. This demonstrates China's willingness to defend its economic interests in response to perceived threats.

United States

During the US-China trade war of 2018, the United States imposed tariffs on Chinese goods with the goal of reducing the trade deficit and protecting American industries. The US targeted a broad range of Chinese imports to exert pressure on China's economy and force concessions, such as greater market access for American companies.

This approach was not unprecedented. The **Smoot-Hawley Tariff Act of 1930** is a historical example of the US using tariffs as an economic tool. This act raised taxes on thousands of imported goods, intending to protect domestic industries during the Great Depression. However, it led to widespread global trade tensions, prompting retaliatory tariffs from other countries and exacerbating the economic recession.

5. UN involvement

Resolution 3281 (XXIX), known as the **Charter of Economic Rights and Duties of States**, was adopted by the United Nations General Assembly on December 12, 1974. It affirms that every country has the right to choose its own economic, political, and social system:

> "Every State has the sovereign and inalienable right to choose its economic system as well as its political, social and cultural systems, in accordance with the will of its people, without outside interference, coercion or threat in any form whatsoever." (Article 1)

This principle is particularly relevant to tax-driven economic retaliation, where one country might use economic measures (such as imposing higher taxes) to exploit another country's economy or influence its internal decisions.

The Charter also emphasizes that countries have full control over their resources and economic policies, including their tax systems, which should be used to support their development. This is especially critical for protecting countries, particularly developing nations, from economic retaliation or forced tax policies imposed by more powerful states:

> "All States have the responsibility to cooperate in the economic, social, cultural, scientific and technological fields for the promotion of economic and social progress throughout the world, especially that of the developing countries." (Article 9)

This is a pressing issue, and the Charter calls on all states to take action. It urges countries to work collaboratively to prevent the harmful effects of tax-driven economic retaliation and to establish a fairer and more stable global economic system.

6. Useful links

- https://quickonomics.com/terms/retaliation/

- https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2778/download
- https://hoover.blogs.archives.gov/2018/03/14/the-smoot-hawley-tariff-of-1930/

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