

# The Age of Economic Nationalism: The End of Globalization?

Editor: Özgür KANBİR



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Editor: Özgür KANBİR

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## Preface

The foundational pillars of the liberal international order, established in the aftermath of World War II, are being shaken to their core. As we stand in 2025, the global economy is at a critical inflection point. The wave of economic nationalism and protectionism, reignited with force by current US President Trump, clearly demonstrates that trade is no longer merely an engine of economic growth but has become a primary instrument of geopolitical tension and the struggle for sovereignty.

For decades, globalization and free trade guided the global economy with the promise of shared prosperity. However, deepening inequalities since the 2008 Global Financial Crisis, coupled with the rise of “national interest” rhetoric, have fueled a resurgence of neo-mercantilist policies. The strategies pursued by the US through tariffs, supply chain restrictions, and geo-economic security concerns show that the global economy has transformed into an arena dominated by “weaponized trade” and “new protectionism.”

At this critical juncture, this edited volume aims to provide a robust analytical framework for a global readership to understand this multidimensional transformation. Going beyond populist rhetoric, this collection seeks to reveal the chronic structural problems behind the current trade wars and their long-term effects on the international order. Starting with conceptual foundations, the book examines this new era through eight distinct lenses, ranging from the structural economic causes of conflict to policy instruments and corporate adaptation strategies.

The first chapter, “Trade Wars in The Context of Economic Nationalism and The Search for Sovereignty” by Ali Kırıktaş and Özgür Kanbir, establishes the theoretical and conceptual framework of the book. The chapter defines economic nationalism as an approach where economic activities are marshaled to serve national interests and goals. It examines the historical origins of economic sovereignty and its transformation in the age of globalization. By comparing Realist and Constructivist approaches, it demonstrates that the US-China competition is both a material power struggle and a clash of worldviews. This section emphasizes how the contemporary quest for technological supremacy and supply chain security adds new dimensions to the traditional understanding of sovereignty. This theoretical and conceptual

framework lays the groundwork for the second chapter, which delves into the historical and philosophical roots of this resurgence.

Building on this foundation, the second chapter, “Surviving in the Age of Economic Nationalism: The Price of Protectionism and Neo-Mercantilism” by Mustafa Acar, focuses on the historical and philosophical underpinnings of modern protectionism. The chapter introduces the fundamental propositions of mercantilism and contrasts them with classical liberal critiques from Adam Smith to David Ricardo. Professor Acar critically evaluates the neo-mercantilist approach, refuting protectionist arguments (national security, infant industries) with arguments for the prosperity, lower prices, and moral superiority that free trade provides. This comparison reveals that the cost of protectionism is ultimately borne by consumers and export sectors. While Professor Acar masterfully contrasts the philosophical arguments for and against free trade, the third chapter examines the concrete, modern-day policy instruments of this new protectionist wave.

The third chapter, “Tariffs and Trade Wars: The Rise of Protectionism in The Global Economy” by Fatma Pinar Eşsiz, examines this new wave of protectionism in the context of geoeconomic security. The chapter addresses the idea that, especially since the 2008 crisis, trade has been weaponized as a geopolitical tool. The US “America First” policies serve as a concrete example of this transformation. The chapter shows that protectionism has evolved beyond traditional tariffs to encompass technology, environmental regulations (like the EU’s Carbon Border Adjustment Mechanism), and the quest for strategic autonomy. It also analyzes how the COVID-19 pandemic exposed the fragility of global supply chains, accelerating this weaponization of trade. This focus on geoeconomic tools finds its most prominent case study in the US-China conflict, which is the subject of the following chapter.

The fourth chapter, prepared by Özgür Kanbir, is titled “The Economic Policy of the US-China Trade War.” This section advances the thesis that the trade war is merely a symptom of deeper, internal structural problems within the US economy. The analysis centers on the chronic “low savings-low net investment” paradox that has plagued the US for decades, a weakness sustained by the “exorbitant privilege” of the dollar’s global reserve status. The data-driven analysis demonstrates that the costs of the Trump-era tariffs were borne not by China but by US consumers and producers, and that the trade deficit was not eliminated but merely shifted to other countries through “trade diversion.” Kanbir’s analysis of national structural issues leads naturally to the question of how domestic policies, such as competition law, are being reshaped by the pursuit of national interests.

This question is addressed in the fifth chapter, “Competition Policy and National Interests: Finding Optimal Regulation” co-authored by Jafar Babayev and Shamsi Rzali. The chapter explores the structural tension between competition law, which aims to protect market efficiency, and the state’s desire to support strategic sectors through subsidies and protective regulations. Central to managing this tension is the Regulated Conduct Doctrine (RCD), which allows for exemptions from competition law scrutiny for actions compliant with legitimate regulatory frameworks. The chapter emphasizes that competition policy requires adaptive, multi-level governance to avoid becoming either a shield for protectionism or an obstacle to legitimate state action. From the general tension between competition and national interest, the book then turns to a specific and potent case of financial nationalism in an EU member state.

The sixth chapter, “From Liberal Orthodoxy to Illiberal Democracy: Hungary’s Turn Toward Financial Nationalism” by Onur Oğuz, provides an in-depth case study of the illiberal turn in financial markets. It details the strategies of Hungary, led by Viktor Orbán, to regain monetary sovereignty in the wake of the 2008 crisis. These measures include reducing foreign currency debt, nationalizing major banks to decrease foreign ownership below 50%, and demanding the closure of the IMF office. This case study serves as a powerful example of how illiberal policies position national interests against the liberal global system. Hungary’s example in the financial sector is mirrored in another critical area for national sovereignty: agriculture and food security.

The seventh chapter, “Economic Nationalism and Agricultural Policies: A Panel Data Analysis” by Burcu Yılmaz Şahin and Halit Levent Orman, empirically analyzes the impact of economic nationalism on this vital sector. Focusing on emerging economies like India, Turkey, Russia, and China, the panel data analysis reveals that while trade openness has historically had a negative effect on the agricultural sector’s share of GDP, recent nationalist policies and food crises have begun to reverse this trend in some countries. The study argues that policymakers must consider country-specific structures and the importance of protective measures. While states erect protectionist barriers, multinational corporations are not passive actors. The final chapter explores a key adaptive strategy they have developed in response.

The eighth and final chapter, “Reverse Innovation: A New Perspective on Globalization” by Hasan Önder Saridoğan, presents this adaptive strategy. Contrary to the traditional top-down flow of innovation, Reverse Innovation describes the process where products developed for low-income

countries are subsequently introduced to high-income markets. This strategy enables transnational corporations to seize growth opportunities and overcome regional barriers in an era of “slowbalization.” Reverse Innovation demonstrates that globalization is no longer a unidirectional force but a multidimensional phenomenon shaped by actors at all levels.

This volume provides a roadmap for making sense of the complex picture presented by economic nationalism and trade wars in the turbulent 21st century. The analyses show that this new era has reshaped not only international trade rules but also the very definition of state sovereignty, the tools of national economic governance, and the strategic behavior of global firms. At a time when the fundamental pillars of the global order are being shaken, our primary goal is for this book to offer the international community and policymakers a more nuanced, data-driven, and in-depth perspective. Ultimately, this collection argues that the rise of economic nationalism is not a fleeting political trend but a structural transformation of the global system, demanding that we fundamentally rethink the old certainties of globalization.

Assoc. Prof. Özgür KANBİR  
Giresun University

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# Trade Wars in The Context of Economic Nationalism and The Search for Sovereignty

Ali Kırıktas<sup>1</sup>

Özgür Kanbir<sup>2</sup>

## Abstract

This chapter examines the intricate relationship between economic sovereignty, economic nationalism, and trade wars, establishing a comprehensive theoretical framework to analyze contemporary international economic conflicts. It applies this framework specifically to the US-China trade war, arguing that the rivalry is a deep, multi-layered phenomenon that cannot be understood through superficial economic indicators alone. The chapter begins by tracing the historical origins and modern transformations of economic sovereignty, demonstrating how globalization has reshaped, rather than eroded, the concept by adding new dimensions like technological and digital sovereignty. It then delves into economic nationalism as the primary ideological force driving this quest for sovereignty, citing policies like the US's "America First" and China's "Chinese Dream" as prominent examples, while also presenting a critical evaluation of the potential inefficiencies and risks associated with such policies.

A central focus of the chapter is its analysis of trade wars through two distinct International Relations theories. The Realist perspective is used to frame the US-China conflict as a classic power struggle for relative gains between a hegemonic power and a rising challenger. In contrast, the Constructivist perspective is employed to illuminate how this struggle is socially constructed—examining the creation of "threat" perceptions, the discourse of "unfair competition," and the central role of national identities and normative claims in legitimizing protectionist actions. The chapter concludes that the

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US-China trade war is a quintessential manifestation of resurgent 21st-century economic nationalism and a transformed understanding of sovereignty, a conflict that is testing the foundations of the liberal international order and has the potential to reshape the future of the global trade regime.

## 1. Introduction

Understanding the fundamental dynamics of modern international relations and global economic politics necessitates an in-depth examination of central concepts such as economic sovereignty, protectionist policies, and economic nationalism. These concepts play a vital role in terms of nation-states' efforts to determine their own economic destinies, strategies to protect national interests, and power struggles within the international economic system (Yoon, 2024). How these concepts, shaped by globalization and increasing interdependence, have evolved, how they interact with each other, and in what direction they have transformed the international order form the central problem of this section.

Economic sovereignty, in its broadest sense, refers to a state's capacity to determine and implement its own economic policies independently of external interference. This definition does not fully explain the internal and external dimensions of sovereignty, its historical origins, and the challenges posed by globalization (Kuşat, 2020, p. 225).

Economic nationalism is based on the idea that economic activities and policies should serve national interests and nationalist goals. In this context, economic nationalism can be described as an ideology and political approach. Economic nationalism advocates for active state intervention in the economy. It also advocates for control of domestic industry and property, with protectionist measures (tariffs, quotas) against imports. Looking at the historical roots of economic nationalism, it is based on mercantilism and the works of thinkers such as Friedrich List and Alexander Hamilton. Consequently, economic nationalism is manifesting itself in policies such as "America First," as seen in the United States today, and in new areas such as technological autonomy and supply chain security (Helleiner, 2002, pp. 314-319).

Another phenomenon closely related to these two concepts is trade wars. This state of economic conflict, in which countries mutually increase trade barriers (tariffs, quotas, etc.) and these measures are often met with retaliation, not only produces economic consequences but also negatively affects political relations between countries. This negativity can trigger broader geopolitical tensions. The pursuit of economic sovereignty and

nationalist policies can often pave the way for tensions such as trade wars in the international arena.

The concepts of economic sovereignty, economic nationalism, and trade wars outlined above will be examined within a theoretical and historical framework. The aim is to lay the groundwork for a deeper understanding of the US-China trade war, one of today's most important international economic and political issues. The US-China trade war has been a concrete manifestation of these theoretical and conceptual debates. In this context, China's rise as a global economic and technological power has prompted certain reactions from the US.

Looking at the trade imbalances between the two countries, it involves multidimensional dynamics such as technological competition, intellectual property disputes, and the clash of nationalist strategies such as "America First" and "Chinese Dream." This case also raises the question of whether it signifies a break or a new phase in the history of the concepts discussed. However, new dimensions such as technology wars and data sovereignty provide important clues as to whether this is a simple repetition of history or the beginning of a new era.

Throughout the chapter, while analyzing phenomena such as trade wars, the focus will not be solely on power and interest struggles, but also on normative questions regarding the social construction of concepts such as fair trade and unfair competition, and the potential impact of these phenomena on international norms, justice, and global welfare. It will be emphasized that the deep economic interdependence brought about by globalization has created new areas of conflict and competition (technology restrictions, supply chain security) and that this paradox will be one of the main topics of examination in this chapter.

In this vein, the chapter is structured as follows: First, the definitions, historical origins, and modern reflections of the concept of economic sovereignty are explained, and the effects of globalization on this concept are examined. Next, the theoretical foundations of economic nationalism, its key thinkers, sources at the individual level, and its reflections in policies are addressed. In this section, Realist and Constructivist theoretical perspectives on trade wars are presented and these two approaches are compared. Finally, a critical assessment of the idea and practices of economic nationalism is provided.

## 2. Theoretical Framework: Economic Sovereignty and Nationalism

This section is important for understanding the fundamental dynamics of modern international relations and global political economy. The section addresses the concepts of economic sovereignty, protectionist policies, and economic nationalism. The theoretical foundations of these concepts, their historical evolution, and their complex interactions with each other will be examined in depth. Furthermore, a comprehensive theoretical framework will be established by presenting realist and constructivist perspectives on trade wars, a significant phenomenon of our time.

### 2.1. Economic Sovereignty: Definitions, Historical Origins, and Modern Reflections

Economic sovereignty is a concept at the center of international relations and political economy disciplines, defined as a nation-state's ability to determine its own economic destiny and independently set and implement its economic policies (Savanović, 2014, p. 1023). However, this general definition does not fully reflect the complexity and multidimensionality of the concept.

In its most general sense, economic sovereignty refers to a state's capacity to determine and implement its own economic policies independently of external interference. However, this concept has acquired various definitions and dimensions in the context of different theoretical approaches and practical applications. Yoon (2024, p. 20) draws attention to the different discourses of sovereignty, noting a potential tension between the state's right to regulate within its own borders (internal sovereignty) and its right to be free from external factors and interventions (external sovereignty). This distinction shows that sovereignty is not merely a matter of internal control, but is also closely related to power relations and normative structures within the international system. Kuşat defines economic sovereignty as one of the cornerstones of the traditional nation-state paradigm and examines the profound changes and transformations that the globalization process has wrought upon this concept. Globalization has led nation-states to enter into more complex relationships with each other and with international organizations, as well as into long-term networks of relationships, which has called into question the classical Westphalian interpretations of economic sovereignty (Kuşat, 2020, pp. 223-230).

A different dimension of economic sovereignty emerges with the concept of "Sovereign Economic Zones" (SEZs). These zones are defined as geographical units with their own autonomous or semi-autonomous

economic jurisdiction and can also exercise a certain form of sovereignty over their residents, who often share a common identity. China's special economic zones are an example of this (Brown et al., 2023, pp. 1-4). The existence of SEZs demonstrates that economic sovereignty can take different forms not only at the nation-state level but also at sub-national levels, and that economic autonomy can be implemented to varying degrees.

From a financial perspective, Bossone has linked economic sovereignty to a country's expansive macroeconomic policies aimed at resource utilization and increasing local production. He also defines economic sovereignty as the ability to effectively implement public finance sustainability and national currency value stability without jeopardizing them (Bossone, 2021, p. 12). This definition emphasizes that sovereignty is not merely an abstract right but is directly linked to practical policy implementation capacity and economic outcomes. Starinskyi and Zavalna, as well as Gevorgyan, similarly treat economic sovereignty as an integral part of national sovereignty and state that a country's authorities must have a decisive role in decision-making processes concerning the future of the national economy and fundamental development priorities (Gevorgyan, 2022, pp. 7-13; Starinskyi and Zavalna 2021). This approach underscores the centrality of autonomy in decision-making mechanisms for economic sovereignty and places significant emphasis on this point.

Furthermore, when supranational structures such as SEZs and the European Union are taken into account, it is evident that sovereignty has transcended the traditional nation-state-centered understanding. Authority and control can be shared or transferred at different levels (sub-national, national, supranational). Therefore, economic sovereignty has ceased to be a static and absolute concept in the era of globalization and has become a dynamic, flexible, and multi-layered phenomenon (Kuşat, 2020, p. 229). This transformation has enabled states to develop new strategies in both domestic and foreign policy.

### 2.1.1. Historical Origins of the Concept of Economic Sovereignty

Looking at the historical origins of the concept of economic sovereignty, it can be said that it is closely related to the emergence of the modern nation-state in Europe in the 16th and 17th centuries. The nation-state model became clearly defined with the Westphalian Order<sup>3</sup> (Kuşat, 2020, pp.

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3 The Westphalian Order is considered the birth of the modern state system. It refers to the international political order established by the Peace of Westphalia (Treaties of Münster and Osnabrück) in 1648, which ended the Thirty Years' War and the Eighty Years' War. This order is considered a historical turning point because it laid the foundation for modern

224-229), which, in accordance with the principle of territorial sovereignty brought about the centralization of political authority within its own geographical borders and the authority to regulate and control economic activities as one of the fundamental characteristics of this authority. During this period, mercantilist policies advocated active state intervention in the economy and the steering of foreign trade in its favor in order to increase national wealth and power. In this context, it can be said that this situation represents an early form of economic sovereignty.

Looking at more recent history, free ports (e.g., Hamburg gaining free port status within the German Empire in 1888) and duty-free zones established in Europe in the 19th and early 20th centuries are important examples of economic sovereignty being applied in different and flexible ways in specific geographical areas (Brown et al., 2023, pp. 1-6). Such zones have been seen to grant partial exemptions from national economic policies. At the same time, they aimed to promote international trade and, consequently, economic growth. Corey Tazzara (2014) examined the geographical spread of free ports in four main phases. These phases are the Tyrrhenian Sea Period (1591-1650), the Expansion Phase (1650-1740), the establishment of free ports in the Caribbean by colonial powers in the mid-18th century, and finally, the stage of expansion to East Asia and North America (Brown et al., 2023, p. 2). This historical development shows that economic hegemony did not always mean strict central control, but that autonomy could also be granted to certain regions in line with commercial and strategic interests.

The forms of land ownership and resource control in ancient empires do not directly correspond to the modern concept of economic sovereignty (Erdoğan, 1999, p. 4). However, it can be said that control over economic resources and production processes has historically been a central element of power and sovereignty. However, these early forms of sovereignty have less direct relevance to discussions of economic sovereignty shaped by the emergence of the modern nation-state and the capitalist world economy.

In the second half of the 20th century, particularly after the decolonization process, the concept of economic sovereignty took on a new dimension. The demands for a New International Economic Order (NIEO) brought to the agenda by developing countries at the United Nations in the 1970s were one of the most important indicators of this new dimension (Yoon, 2024, p. 21). The NIEO aimed to strengthen the political independence of

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international relations and the current system of states. At its core lies the principle that each state has absolute sovereignty over its own territory and is independent of external interference (Çiftçi, 2018) .

developing countries with economic independence . In particular, it included demands to implement the principle of permanent sovereignty over natural resources (PSNR) and to reorganize the rules of the global economic system in a more equitable manner (Yoon, 2024, pp. 18-19). This movement demonstrated that economic sovereignty is not merely a formal declaration of independence. It also sought to convey that proactive economic power entails effective control over resources. Ultimately, PSNR emphasized the necessity of fair international economic rules.

Looking at the historical course of the quest for economic sovereignty, it can be seen that it has developed along two main axes. The first is the struggle of nation-states to protect, regulate, and control their own internal economic spheres from external interference. This can be seen as a reflection of the Westphalian concept of sovereignty in the economic sphere. This involves the state's claim to authority over economic activities within its own borders. The second is the struggle of states to change the rules of the international economic system in their favor or to gain more autonomy within this system. The NIEO initiative can be said to be one of the most prominent examples of this second axis. It has shown that economic sovereignty is not only an internal issue, but also a goal to be achieved in the context of global power relations and international institutions (Yoon, 2024). Historical and modern examples such as free ports and special economic zones show that sovereignty is not an absolute and indivisible concept, but rather can be applied pragmatically and flexibly in line with the strategic and economic interests of states. It reveals that certain elements of sovereignty can sometimes be strategically relaxed or transferred to specific regions (Brown et al., 2023, pp. 2-5). This historical trajectory shows that economic sovereignty is actually a dynamic process that is constantly influenced by internal and external dynamics, rather than a passive state.

### **2.1.2. The Twentieth Century and the Era of Globalization**

From the late 20th century onwards, the globalization process has profoundly affected the modern reflections of the concept of economic sovereignty and redefined the traditional roles of nation-states. Interdependence and interaction in economic, social, political, and cultural spheres have increased. This situation has necessitated nation-states to enter into more complex and long-term relationships with other states and international organizations (e.g., the World Trade Organization, the International Monetary Fund, the World Bank). This process has led to changes in many national structures, institutions, and concepts. In particular, it has paved the way for the erosion of the traditional nation-state phenomenon and the associated concept of

economic sovereignty (Kuşat, 2020, pp. 224-225). The rise of liberalism on a global scale has caused national borders to become increasingly permeable in economic terms. At the same time, the growing influence of transnational economic actors (multinational corporations, global financial markets) has been an important factor reinforcing this situation.

However, claims that globalization has completely eliminated economic sovereignty or rendered states entirely powerless against market forces should be evaluated with a critical approach. International economic integration has had restrictive effects on sovereignty. Nevertheless, it is thought that claiming that governments have become completely ineffective in the face of market forces can only be the result of an ideological or biased perspective. Indeed, rather than passively submitting to the new conditions brought about by globalization, states have aimed to protect their national interests in this process. They have developed various strategies to improve their position within the global economic system. Conceptualizations such as the “catalyst state” or the World Bank’s (1997) “effective state” show that states have taken on a number of new roles in directing and regulating market mechanisms (Ünay, 2009, p. 119).

In the modern world, the pursuit of economic sovereignty manifests itself in various forms. These include: protecting domestic production bases and industry (Chang, 2008, p. 71), reducing external dependence and localization efforts in strategically important sectors (energy, food, health, defense) (Rodrik, 2012, p. 189), the ability of countries to independently determine their own development models and strategic choices (Evans, 1995, p. 47), and the alignment of economic activities with environmental sustainability principles (Meadows et al., 2004, p. 215). For example, France decided to bring the production of critical drugs such as *paracetamol* back to the country after the COVID-19 pandemic. In this context, France has been striving to increase national competitiveness and international influence by investing in producers in strategic sectors through its 2030 plan. This situation, exemplified by France, has been a concrete manifestation of the quest for modern sovereignty. Similarly, even within supranational structures such as the European Union, the concepts of strategic autonomy and European sovereignty are becoming increasingly important for the bloc to compete with global powers and protect its own interests.

However, the dynamics of the global financial world impose a significant constraint on economic sovereignty. In the global financial system, investors play a decisive role in the effectiveness and feasibility of national macroeconomic policies. These global investors, with the large funds

they manage, can influence a country's public sector debt (bonds, bills) and the value of its currency in international markets. This situation can narrow the policy maneuvering space of national governments. According to Bossone, this situation means that, in theoretical terms, no country can be fully economically sovereign. This is because every country has been subject to a kind of intertemporal budget constraint, and as a result, has faced the risk of losing the confidence of global investors. In this context, John Maynard Keynes' deep knowledge of the functioning of international financial markets and his prudent policy recommendations (e.g., sustainable debt management, control of capital movements) remain relevant to today's debates on economic sovereignty (Bossone, 2021, p. 9).

Another important concept regarding the role of states in the era of globalization is the *competitive* state. This approach argues that the fundamental role of states is no longer just to distribute welfare or regulate markets, but also to dynamically adapt to international market conditions, enhance the competitiveness of the national economy, and create an investment environment that encourages entrepreneurship. However, this model has the potential to conflict with the broad-based socioeconomic development goals and social justice concerns of developing countries in particular (Ünay, 2009, pp. 113-118).

New dimensions added to the economic sovereignty debate include environmental sustainability and technological independence. Staronynskyi and Zavalna, when addressing economic sovereignty in the context of sustainable development goals, emphasize the critical role of green technologies and renewable energy sources in strengthening a country's energy independence and, consequently, its economic sovereignty (2021, pp. 7-13). Similarly, the concept of technological sovereignty, which today means self-sufficiency and reduced external dependence in strategic technologies such as data sovereignty, artificial intelligence, and semiconductors, has become vitally important in terms of national security and economic competitiveness (Ünay, 2009, p. 127). Conceptual developments regarding economic sovereignty are progressing in four main directions: the contribution of economic factors to maintaining overall national sovereignty, the degree of autonomy in economic policy formulation and implementation, the capacity for self-sufficiency in key economic development areas, and economic resilience and sustainability against negative external shocks such as trade wars or international sanctions (Ünay, 2009, p. 130).

Modern economic sovereignty is shaped by a complex tension between the challenges posed by globalization and nation-states' strategic quest for

self-governance and self-determination (Kuşat, 2020, pp. 235-237). This situation is a dynamic concept that is constantly renewed and redefined by national and transnational actors (Krasner, 1999, p. 20). In other words, it shows that economic sovereignty is not something that is easily lost or gained. Thus, new issues such as environmental sustainability (Daly & Cobb, 1994, p. 142), technological independence, and data sovereignty have become important and increasingly central proactive elements in the definition process (Zuboff, 2019, p. 376). States are forced to develop more original and multi-layered strategies in both domestic and international politics to adapt to these new conditions and protect their sovereignty (Weiss, 1998, p. 211).

## **2.2. The Convergence of Nationalism and Economics: Economic Nationalism Theories**

Nationalism, one of the powerful ideologies of the modern era, has had a profound impact on politics, society, and culture. This situation has also been effective in the economic sphere, giving rise to economic nationalism as a reflection of nationalism in economic thought and policies.

### **2.2.1. Definition and Core Values of Economic Nationalism**

In its most basic sense, economic nationalism is an ideological and political approach based on the idea that economic activities and policies should prioritize national interests and serve nationalist goals (Helleiner, 2021, p. 4). This approach advocates for active state intervention in the economy. These interventions may include control of domestic industry and property, as well as protectionist measures such as import tariffs and restrictions on the movement of labor, goods, and capital (Spero & Hart, 2009, p. 15). At the core of economic nationalism lies the idea that markets should be subordinate to the state and the general interests of the nation (e.g., national security, military buildup, industrial development, job creation) (Gilpin, 1987, p. 44).

Robert Gilpin defined the central idea of economic nationalism as “economic activities being and having to be subordinate to the goal of state building and the (national) interests of the state” (Helleiner, 2002, p. 309). However, Eric Helleiner has pointed out that Gilpin’s definition carries a “statist” emphasis and does not sufficiently incorporate the “nationalist” element. The concept aims to offer a broader perspective by including dimensions such as national identity, national loyalty, and the welfare of the nation. According to Helleiner, economic nationalism can include policies that seek not only the interests of the state but also the collective identity and

welfare of the nation. In some cases, the fear of countries being left behind in the global economic system or having their rights violated has given rise to economic nationalism. Some policies observed in the US in response to China's economic rise can be cited as examples of this (Helleiner, 2002, pp. 314-319).

Economic nationalism is one of three main schools of thought regarding the nature and functioning of the international economy. Often mentioned alongside economic liberalism and Marxism, this perspective holds the belief that the economy is subordinate to social and political goals. Economic nationalism is concerned with the nation itself beyond the economy, and its economic dimensions only gain meaning within the context of a specific national discourse (Reinert, 2023: 88). Essentially, the nature of the economy is based on nationalism (Szljajfer, 2012: 78).

The fundamental characteristics and policies advocated by economic nationalism are as follows:

- a. The Central Role of the State and National Interest:
  - Economic nationalism advocates that the state should play a central role in economic development. The state directs the market rather than following it.
  - The state is the central actor of the nation, the bearer of the nation's interests and the source of the means to implement them (Reznikova et al. 2018: 277).
  - States believe that the ultimate goal of economic activity is to maximize national power rather than to benefit individual consumers or increase social welfare. The nation-state remains the dominant actor in both domestic and foreign economic relations and uses its significant power to influence economic outcomes.
  - While the logic of the market is to locate economic activities where they are most efficient and profitable, the logic of the state is to seize and control the process of economic growth and capital accumulation in order to increase the nation's power and economic welfare. This creates an inevitable conflict between the logic of the market and the logic of the state.
  - In some countries, the state has been regarded as the "greatest capitalist and entrepreneur," serving as the primary driver of economic growth (e.g., Poland in the 1930s) (Szljajfer, 2012: 338; Suesse, 2023: 107).

- The state's goal of protecting long-term private interests requires aligning political power and economic growth curves (Szajfer, 2012: 55).

b. Protective and Strategic Policies:

- Economic nationalists believe that protective policies (trade barriers, subsidies, etc.) should be implemented to protect and strengthen national industries. It is noted that in the past, every successful industrial power pursued protective policies to shield its "infant industries" until they became strong enough to withstand international competition.
- Strategic sectors (high-tech industries such as computers, semiconductors, and information processing) are assumed to be more important to the overall economy than others and therefore deserve government support.
- This may include policies such as encouraging exports, controlling imports (e.g., through currency monopolies in Japan), supporting local employment, and even discriminating against minority entrepreneurs (e.g., the Turkification policies of the Ottoman Empire from 1908 onwards and during the founding years of the Republic of Turkey, and the Polonization policies in Poland) (Suesse, 2023: 206-289).
- Economic nationalism can also manifest itself in the form of resource nationalism; this is the state's defense of its right to direct the ownership, taxation, and extraction of natural resources for the purpose of national development (Haslam and Heidrich, 2016: 223-235).

c. Rejecting Market Autonomy and Relative Gains:

- Unlike neoclassical economists, who view the market as an autonomous, self-regulating mechanism, economic nationalists assume that markets are embedded within broader socio-political structures, and that these structures significantly determine the role and functioning of markets.
- Economic nationalists focus on relative gains rather than absolute gains in international economic relations. It is emphasized that although the free market provides absolute gains for everyone, these gains are not distributed equally, and states attach great importance to their own relative gains (Hellenier, 2021; Gilpin, 2001: 182).
- There is a belief that market mechanisms must be controlled to serve national objectives.

d. The “Development State” Model:

Explaining the success of Newly Industrialized Economies (NIEs), particularly in East Asia, this theory argues that the state plays a pioneering and guiding role in the economic development process. In this model, the state uses various tools such as industrial policies, trade protection, subsidies, and financial pressure to overcome market failures and promote rapid industrialization. The ultimate goal is to achieve economic autonomy and political independence. Economic openness and growth are emphasized as indicators of the transition to “mature nationalism” (Suesse, 2023: 150).

e. Relationship with Other Economic Ideas and Nuances:

- It has been noted that economic nationalism and economic liberalism are contradictory, but that the capitalist class tries to embrace both ideologies at the same time (Bresser, 2018: 12).
- In some cases, liberalization can be used as a tool to achieve nationalist goals (Hellenier and Pickel, 2018: 12). For example, post-communist Estonia liberalized its economy to distance itself from the Russian threat and to “strengthen the national spirit” (Scepanovic, 2019: 220).
- Today, it is also referred to as “economic patriotism” or “new variations of economic nationalism,” and these concepts are seen as 21st-century economic nationalism (Reznikova et al. 2018: 275).
- Techno-nationalism involves state-supported efforts to achieve self-sufficiency and leadership in critical technologies (e.g., semiconductors).
- It rejects the “complete autonomy” of the market.
- The content of economic nationalism policies may be ambiguous depending on the diversity of national identities and contexts within the global system (Hellenier and Pickel, 2018: 225).
- The belief that “capital has a nationality” has been rediscovered (Szalajfer, 2012: 78).
- Populist movements, anti-globalization reactions, and the rise of economic nationalism have been linked to factors such as deindustrialization, migration, and corruption (Obstfeld, 2021).

These definitions and characteristics reveal that economic nationalism is not merely a narrow economic theory, but rather a complex socio-political and economic phenomenon deeply intertwined with national identity, power, and development goals (Reinert, 2023: 88).

Economic nationalists adopt a skeptical stance toward the negative effects of globalization and unrestricted free trade. Therefore, economic nationalists advocate for national and self-sufficiency and protectionism (Balaam & Dillman, 2019, p. 34). They tend to view international trade as a zero-sum game, contrary to the mutual gain view of liberal theorists. The fundamental goal here is to gain relative advantages over other countries (Gilpin, 1987, p. 53). Industrialization occupies a central place in economic nationalist thought. This is because it is believed that industry has positive spillover effects on the economy, increasing the country's self-sufficiency and political autonomy. At the same time, it is considered a critical element in building military power (Chang, 2008, p. 68). Historically, mercantilism is considered a leading variant of economic nationalism, with its practices of actively directing foreign trade and targeting the accumulation of precious metals (Helleiner, 2021, p. 15).

### **2.2.2. Theoretical Perspective on Trade Wars**

Trade wars represent one of the sharpest forms of tension and disagreement in international economic relations. These processes, in which countries mutually increase trade barriers, can have significant effects on the global economy and the international system.

Trade wars, in their most general definition, are economic conflicts in which countries impose tariffs on each other's imports, increase protectionist measures such as quotas, subsidies, or other trade barriers, and often respond to these measures with retaliatory actions. Although such conflicts usually start in specific sectors, they can quickly spread and affect a broader economic area. The fundamental dynamics of trade wars primarily involve a country protecting its domestic industry and reducing its trade deficit. At the same time, they aim to prevent unfair competition and gain a strategic advantage. However, such actions generally lead to the other side responding with similar measures. This situation can turn into a "tit-for-tat" spiral, leading to a general contraction in trade. It can also cause disruptions in global supply chains, increased economic uncertainty, and potentially slow global economic growth (Ünay and Dilek 2018, p. 8).

The theoretical study of trade wars addresses three fundamental questions: *causes, interaction processes, and outcomes* (Guoyong and Ding, 2021) .

### **2.2.3. Trade Theory Perspectives:**

a. Traditional Free Trade Theory: Argues that free trade maximizes global welfare and that no country can profit from a tariff war. The net welfare effect

of a tariff is calculated by comparing government revenues (tariff revenue and trade surplus gains) with losses in consumer and producer surplus.

b. Optimal Tariff Theory: It suggests that a country can determine an optimal tariff level that maximizes national welfare, provided that the other country does not retaliate. It shows that tariff wars between countries of different sizes can benefit the larger one while harming the smaller one.

c. Strategic Trade Policy (New Trade Theory): Argues that the government can take measures such as export subsidies or tariffs to protect local industries and transfer profits in industries that are not fully competitive.

d. Political Economy: Trade frictions may arise from internal political processes where governments pursue policies that maximize political support rather than economic welfare. The underlying idea here is that governments pursue policies that reflect the interests of influential interest groups. Non-cooperative tariff games that model policy dependence, negotiated trade agreements, the existence of tariff-distorted equilibria, and the influence of special interest groups on national policies are all relevant. Looking specifically at the US, this influence can be seen in the Trump administration's relationship with its voter base and interest groups, referred to as MAGA (Make America Great Again) supporters, and in the policies it has implemented.

c. Game Theory Approach: Emphasizes the interactive nature of trade wars and helps define the process. Trade wars generally involve a variable-sum game with strategic interactions between players. This theory is divided into two types: static games and dynamic games.

Static Games are based on simultaneous decisions. The Prisoner's Dilemma, where both countries choose to apply tariffs (violation/default) as the dominant strategy, but this leads to losses for both, is the most common structure. Chicken Hunt is a situation where mutual violation leads to the worst outcome (Chicken). Stag Hunt is another possible game structure where coordinated cooperation is preferred.

Dynamic Games, on the other hand, are based on repeated decisions. Repeated and sequential games can lead to cooperation strategies by helping players understand the benefits of cooperation. For players with a high discount factor (value of future returns), cooperation may be possible in infinite repeated games.

### 2.2.4 The Context of International Relations

Trade wars not only produce economic consequences but can also negatively affect political relations between countries. In this context, trade wars can trigger broader geopolitical tensions.

a. **Realist Perspective:** Realism is historically the oldest and most influential approach within international relations theory. From a realist perspective, trade wars are seen as an economic reflection of inter-state power struggles.

**Basic Assumptions:** According to realism, the international system has an anarchic structure, meaning that there is no higher authority that can control states (Ahmed, 2023, p. 47; Waltz, 1979). Realism accepts states as the primary actors in this anarchic structure. The primary objectives of these states are to ensure their own survival and maximize their national security. They also aim to maximize their power within the international system. States are generally considered rational and unitary actors; that is, they make decisions based on cost-benefit analysis in line with their national interests.

**Reasons for Trade Wars:** According to realists, states may engage in trade wars to protect their national interests (economic prosperity, industrial capacity, technological superiority, national security) and, in particular, to increase their relative gains compared to other states (Ahmed, 2023, pp. 47-48). Important factors triggering trade wars may be certain changes in the balance of power in the international system and struggles for hegemony. For example, a rising power may threaten the position of the existing hegemonic power. This hegemonic power, whose position is under threat, may use trade pressure tools to maintain its supremacy. The recent US-China trade war is a concrete example of this situation. According to realists, China is rapidly advancing as a rising economic and technological power. China is challenging the US, the global hegemon. The US appears to be striving to protect its position in response to this challenge (Ahmed, 2023, pp. 51-54).

**State Power and National Interest:** From a realist perspective, trade policies and trade wars are used as instruments of state power (Ahmed, 2023). It can be said that national interest is generally defined in terms of material power (military capacity, economic size) and security. Realists think the exact opposite of what liberal theorists believe. In this context, they do not believe that economic interdependence will always bring peace and cooperation. On the contrary, they think that increasing interdependence will create dependency and fragility among states. They argue that this will not reduce the possibility of conflict but, on the contrary, may increase it.

**The Effects of Trade Wars:** Trade wars are seen as an inevitable power struggle between states. This struggle is actually viewed as a zero-sum game. In other words, one state's gain means another's loss. Realists believe that international institutions (such as the WTO) have limited capacity to restrict state behavior and prevent trade wars. This is because powerful states can disregard these institutions and use them to their advantage, acting in accordance with their own interests (Ahmed, 2023, pp. 47-52). Alliances have generally been temporary and interest-based; states can even target their allies in pursuit of their national interests.

b. Constructivist Perspective:

Constructivism is an approach that argues that, in international relations, ideas, norms, identities, and social interactions play an important role in shaping state behavior and the international system, in addition to material factors (Mainasara, 2025, p. 189).

**Basic Assumptions:** Social construction is important in constructivism because international relations and the structure of the international system (e.g., anarchy) are socially constructed. This shows that states' interests and identities are not fixed and not externally given, but rather are formed and can change over time through interstate interactions, shared norms, cultural understandings, and historical experiences (Mainasara, 2025, pp. 189-190). In the words of Alexander Wendt, "anarchy is what states make of it" (Mainasara, 2025, p. 185); anarchy itself does not inevitably produce conflict or cooperation, meaning that how states perceive each other and define their relationships is important at this point.

**Causes of Trade Wars:** When assessed from a constructivist perspective, trade wars do not arise solely from conflicts of material interests or shifts in the balance of power. They can also arise from differences or disagreements in shared (or conflicting) understandings, norms, identities, and discourses. Concepts such as fair trade, unfair competition, national security threats, and economic aggression are seen to have no objective reality. These concepts are socially constructed by political actors and societies. They are disseminated and legitimized through specific discourses. States can define each other as rivals, enemies, unreliable partners, or, conversely, as friends and allies. Within the context of these definitions, states can profoundly influence their trade policies and the likelihood of conflict. For example, in the US-China trade war, China's rise is perceived as a threat. Consequently, the discourse of unfair trade practices is becoming widespread, and technological competition is being framed as a national security issue. These concepts shape the attitudes

of the American public and politicians. At the same time, they have played an important role in legitimizing protectionist policies (Imran, 2024).

**Identities and Norms:** The importance states attach to their national identities (e.g., global leader, rising power, defender of democratic values, authoritarian revisionist) and international norms (e.g., free trade norms, fair competition principles, human rights, rule of law) and their compliance with these norms can influence their trade policies and approaches to international economic conflicts. Martha Finnemore and Kathryn Sikkink's work on types of norms (regulatory norms, constitutive norms, evaluative/prescriptive norms) provides an analytical framework in this context (Mainasara, 2025, pp. 189-191). In a trade war, parties often defend their own actions as compliant with international rules or legitimate, while characterizing the other party's actions as rule violations.

**Discourse and Social Interaction:** The language and discourse used by leaders, politicians, the media, and other opinion leaders play an important role in shaping the public's and policymakers' perceptions and attitudes toward trade wars (Sezgin, 2008, p. 105). The social construction of threats occupies a central place in this process. Viewing a trading partner as hostile or unreliable can facilitate the acceptance of protectionist and retaliatory policies. Through interstate social interactions such as diplomacy, negotiations, and public statements, trade wars can be escalated or defused.

Realism is a theory that focuses on cause-and-effect relationships when explaining trade wars. While concerned with which states engage in war, it examines the objectives behind these wars. Constructivism, on the other hand, approaches this question in a different and more profound way, seeking answers. In this context, it focuses on how states' identities are formed and why these identities change. It analyzes how interests, threats, and goals are defined. In making these definitions, it does not ignore social construction processes. It examines conflicting and shared ideas, values, and norms. For example, Realism may explain the US-China trade war as an inevitable struggle between two great powers for economic and strategic supremacy (Ahmed, 2023, pp. 49-50). Constructivism, on the other hand, questions why this struggle emerged at this particular time. It seeks to understand why it emerged under the label of a trade war. It addresses why and how China is perceived as an economic threat or systemic rival. It also analyzes how discourses such as unfair trade practices or forced technology transfer are constructed. Depending on this situation, it reveals the extent and nature of their relationship with American or Chinese national identities. It does so by questioning how this relates to their historical narratives and

future visions (Imran, 2024). For example, the restrictions imposed on Huawei's 5G equipment on national security grounds can be seen, from a realist perspective, as a move to protect or increase military and economic power. From a constructivist perspective, this is interpreted differently. In this context, the question arises of how technological leadership identity is constructed. Furthermore, it is closely related to how the perception of security vulnerabilities and the label of unreliable actors are constructed through social and political processes.

These two theoretical approaches can complement each other. This is because explaining trade wars solely in terms of material power factors is insufficient. The formative impact of ideas, norms, and identities in this context is significant. However, there have been times when ideas have clashed or, at times, been shared. This point has led to the combined use of Realism and Constructivism. Ultimately, examining both theories together will provide a more comprehensive understanding of trade wars.

Trade wars have been more than just an extension of specific economic policies or a definition of inter-state power competition. They are critical arenas where international norms, rules, and the international order in general are being re-examined, questioned, and potentially transformed. When viewed through a realist lens, the power struggle, when approached from a constructivist perspective, reveals a clash between different worldviews, alternative economic models, different paths to development, and competing claims to legitimacy (e.g., China's discourse on a new type of international relations or a community with a shared future for mankind versus the emphasis on a rules-based international order by the US and its Western allies). These conflicts and negotiations do not only affect the present. They also affect the outcomes of the current trade wars. This situation will most likely shape the global trade regime. This process may affect the normative foundations of the international order. In short, these struggles have the power to shape the global system of the future. During trade wars, serious questions may arise about the effectiveness and legitimacy of existing international trade rules and institutions. However, when viewed from a realist perspective, powerful states can influence these institutions in their own interests. They can even ignore these institutions when necessary for their own interests (Ahmed, 2023, p. 51). The rhetoric used by the parties during these wars and the justifications they put forward (such as the national security exception, unfair competition conditions, forced technology transfer claims, and supply chains linked to human rights violations) inevitably contain certain normative claims and counterclaims (Imran, 2024). In this context, the parties attempt to justify their own actions. To do so, they refer to international law and

norms. At the same time, they claim that the actions of the opposing party are unlawful. They argue that these actions are unjust and aggressive in nature. This situation can create a kind of normative competition or war of rhetoric. This process may lead to the weakening or reinterpretation of existing international norms, such as the norm of free trade and the principle of non-discrimination, and a narrowing of their scope (e.g., the arbitrary expansion of the national security exception). Trade wars do not only produce short-term economic consequences, such as changes in trade flows and winners and losers in specific sectors, . They can also have long-term and potentially transformative effects by affecting the normative structures and power balances that form the basis of the international system. This will help us understand the deeper and more lasting meanings and consequences of trade wars by going beyond the power- and interest-focused explanations of realist analysis and incorporating their social and ideological dimensions, as constructivist analysis does.

The table below presents a comparative overview of the fundamental assumptions and approaches of realist and constructivist perspectives on trade wars:

*Table 1: Comparison of Realist and Constructivist Perspectives on Trade Wars*

| Feature                            | Realist Perspective                                                                        | Constructivist Perspective                                                                                                               |
|------------------------------------|--------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------|
| Nature of the International System | Anarchic (no supreme authority).                                                           | Socially constructed (anarchy is shaped by the meaning states assign to it)                                                              |
| Key Actors                         | Nation-states (rational, unitary state structure).                                         | States, international organizations, civil society organizations, individuals (whose identities and interests are socially constructed). |
| States' Fundamental Motivations    | Survival, security, power maximization, relative gains.                                    | Expression of identities, conformity to norms, search for legitimacy, shared values, material interests (socially defined).              |
| Main Causes of Trade Wars          | Power struggles, national interest conflicts, pursuit of relative gains, security dilemma. | Identity conflicts, norm violations, misperceptions, social construction of threats, legitimacy crises, discursive competition.          |
| The Role of Identities             | Generally secondary; states are seen as black boxes with similar functions.                | Central; states' identities (leader, follower, revisionist, etc.) shape their interests and behavior.                                    |
| The Role of Norms                  | Limited; powerful states use or disregard norms for their own interests.                   | Significant; norms (regulatory, constitutive, evaluative) constrain, enable, and legitimize state behavior.                              |
| The Role of Discourse              | It is generally excluded from analysis.                                                    | Central; discourse constructs reality, defines identities and interests, and legitimizes policies.                                       |

|                                                                     |                                                                                                                                     |                                                                                                                                                                                                              |
|---------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Effectiveness of International Institutions</b>                  | Limited; it is a reflection of states' power and interest struggles.                                                                | Potentially effective; it can disseminate norms, shape identities, and facilitate social learning.                                                                                                           |
| <b>Potential for Change</b>                                         | Limited; dependent on shifts in power balances.                                                                                     | High; if ideas, norms, and identities change, the international system can also change.                                                                                                                      |
| <b>Application to the US-China Trade War (Explanatory Examples)</b> | The US's effort to maintain its hegemony and counterbalance China's rise; a struggle for relative economic and technological gains. | The construction of the China threat narrative; differing interpretations of fair trade and national security norms; the clash between the two countries' great power identities and visions for the future. |

*Source: Table created by authors.*

### 2.2.5. Theoretical Origins and Thinkers of Economic Nationalism

The roots of economic nationalist thought extend back to the era when classical liberal economics (Adam Smith and David Ricardo's theories of free trade and comparative advantage) prevailed. These thinkers opposed the universalist and cosmopolitan assumptions of liberalism. In this context, they emphasized the central role of the nation-state in economic development and the priority given to national interests. In this regard;

Friedrich List (1789-1846): He is recognized as one of the important theorists of economic nationalism. List criticized Adam Smith's "cosmopolitan economy" approach, which focused on the individual and the global economy, and instead developed the concept of the "national political economy system." According to List, each nation has its own unique historical, cultural, and economic conditions, and economic policies should be shaped according to these national realities. He argued that countries at the beginning of the industrialization process or with infant industries should temporarily apply protective customs tariffs to protect themselves from competition from more developed countries (Kibritçioğlu, 1996, p. 52). List stated that the goal was to achieve free trade. However, he believed that this strengthening would only be possible after national industries had become sufficiently strong. For him, the fundamental goal was to increase the "productive power of the sovereign community" rather than individual consumer sovereignty (Breakthrough Institute, 2012). List's ideas have been influential in industrialization strategies, particularly in industrialized countries such as Germany and the United States.

Alexander Hamilton (1757-1804): He was one of the founding fathers of the United States. He was also the first Secretary of the Treasury. Hamilton was an important representative of economic nationalism. He wrote the

famous work “Report on Manufactures.” In this work, he argued that domestic industries (infant industries) should be protected and encouraged by the state in order to increase the economic independence and power of the young American nation (Kibritçioğlu, 1996, p. 64). He stated that the transition from an agriculture-based economy to an industrialized economy was necessary for national welfare and security.

**Other Thinkers and Schools:** In addition to List and Hamilton, economic nationalist thought was also developed in the 19th century by intellectual movements such as the “American National Economy School” and the “German Historical School” (Breakthrough Institute, 2012). These schools, which argued that historical, cultural, and national issues should be included in economic analysis, opposed the abstract and universalist models of classical economics.

Economic nationalism is not merely a phenomenon limited to the policies pursued by states. It is also closely related to individuals’ attitudes, behaviors, and identities. Authors such as Pablo Pinto and Carmen M. Le Foulon (2007) have argued that the sources of economic nationalism are not only at the state level but must also be sought at the individual level. According to their survey data, they have shown that individuals’ economic nationalist attitudes are influenced both by their personal financial interests (e.g., whether the sector they work in is affected by foreign trade, their skill levels) and their ideological preferences (such as nationalism, patriotism, chauvinism). In particular, they have shown that individuals may support protectionist policies in order to support national industry and the economy, even if this conflicts with their own narrow material interests. It has been observed that feelings of nationalism (measured as patriotism and chauvinism) can significantly influence individuals’ attitudes towards import restrictions. This effect may vary depending on factors such as the individual’s position in the economy (level of education, sector of employment) (Pinto and Le Foulon, 2007, pp. 5-10).

There are also various theories explaining economic nationalism in the context of consumer behavior. According to Obasun, these theories can be summarized as follows (2025: 469):

*Social Identity Theory:* It suggests that individuals may prefer domestic products in order to highlight their national identity and demonstrate their loyalty to their national group.

*Social Exchange Theory:* It states that consumers may consider the spiritual benefits of contributing to national prosperity by purchasing domestic

products to be more valuable than the potential costs (higher prices, lower quality, etc.).

*Symbolic Interactionism:* This theory states that domestic products are a source of national pride and can carry symbolic meanings such as cultural heritage or specific social values. It suggests that consumers may make choices based on these meanings.

*Consumer Ethnocentrism Theory:* This theory was developed by Shimp and Sharma. The theory argues that consumers believe it is morally right to buy products produced in their own country. It also states that consumers believe this behavior is patriotic and that they display a negative attitude towards foreign products. This attitude can become stronger, especially in times when the national economy is weak or when there is intense foreign competition.

#### **2.2.6. Reflections of Economic Nationalism in Policies and Historical Examples:**

Economic nationalist ideas have found concrete reflections in the economic policies of many countries throughout history and today. Early trade wars occurred between the 17th and 19th centuries. Significant conflicts took place, particularly during the British-Dutch and British-French trade wars. These wars were fueled by rising nationalism, mercantilism (Colbertism), and protectionism (Guoyong and Ding, 2021, p. 8) .

France: It is a country where the state plays a significant role in the economy. It pursues important policies to prevent companies considered strategic from falling into foreign hands. In other words, economic patriotism prevails in the country. The efforts made in 2004 to keep Societe Generale bank French or Prime Minister Dominique de Villepin's 2005 economic patriotism slogan are examples of this.

*United States:* Regulations such as the Exxon-Florio directive of 1988, which was later revised, gave the federal government the authority to block foreign acquisitions deemed a threat to national security. Restrictions on foreign ownership were imposed, particularly in sectors such as air transport and media. Other notable examples include Congress's opposition in 2005 to the acquisition of the American oil company Unocal by China's CNOOC, and the blocking of Dubai Ports World's attempt to operate some American port terminals in 2006.

Looking at US Policies During the Trump Era US President Donald Trump implemented policies under the slogan "America First." In particular,

he raised customs tariffs in response to China's economic rise. At the same time, he has worked to renegotiate trade agreements and promote domestic production . Such actions demonstrate that Trump actually attaches importance to economic nationalist elements (Tokatl, 2025).

*Germany:* Public institutions have continued to dominate, particularly in the financial sector. This sector has been largely closed to foreign investors. This situation can be cited as an example of economic nationalist tendencies in the German model.

*Global Crises and Nationalist Responses:* Major economic crises, such as the Great Depression of 1929 and the Global Financial Crisis of 2008, may cause nation-states to adopt inward-looking and nationalist policies aimed at protecting their national economies and interests rather than international cooperation. As a reflection of this trend, states intervening in markets and undertaking rescue operations for domestic industries during times of crisis can be cited as examples (Hoffmann, 2001; Federal Reserve Bank of Boston, 2011).

Economic nationalism is not limited to the macro-level policies pursued by states. It is also a multi-layered and complex phenomenon that extends to individuals' consumption preferences, investment decisions, and, more broadly, perceptions of national identity (Helleiner, 2002). Historically, it has been more closely associated with traditional protectionist policies such as customs tariffs and quotas, but its manifestations in the modern world have been much more diverse. When looking at economic nationalism today, it includes the pursuit of technological autonomy and independence (e.g., 5G technologies, semiconductor production), ensuring the security of critical supply chains (medicine, food, energy), and strategies to create and support national champions. At the same time, it can also include more specific and future-oriented goals such as data sovereignty and control of digital infrastructure (Larsen, 2022; Lewis, 2022; Schmalz, 2024). This situation demonstrates that economic nationalism is a proactive process that operates both *top-down* (through state policies and strategies) and *bottom-up* (through the preferences and demands of individuals and consumer groups).

Looking at the rise of economic nationalism, significant shifts in global economic power balances are generally at play. In this context, economic nationalism has emerged as a response to increased international competition and the redefinition of national identities and interests. The arguments for catch-up industrialization and protectionism developed by thinkers such as Friedrich List for countries lagging behind in the industrialization race may find a basis of legitimacy, especially for developing countries or emerging

powers (Kibritçiöğlu, 1996, p. 49). Such economic nationalism can increase technological capacity as well as transform the country's economic structure. According to this view, economic nationalism can be defensive or developmental in nature, aiming to achieve a more advantageous position in the international system.

On the other hand, economic nationalism in developed and globally influential countries can generally be seen as a struggle to preserve existing economic advantages, technological superiority, and global influence, or to regain advantages thought to have been lost in the past. The character of this type of economic nationalism can be more aggressive, status quo-oriented, or hegemonic. For example, some of China's economic policies in recent years have been interpreted as a catch-up and development strategy. Consequently, the US has taken certain measures against China's rise (Tokatlı, 2025). These measures can be seen as a reaction aimed at protecting current global leadership and economic advantages. The historical and current practices of European countries such as France and Germany, on the other hand, reflect a continuous state tradition of protecting national interests and strategic sectors. This shows that economic nationalism may be related to the existential concerns of the nation-state rather than being merely a cyclical reaction. These different motivations indicate that economic nationalism is not a single phenomenon. In this context, it shows that it takes different forms and serves different purposes depending on each country's unique historical, economic, cultural, and geopolitical conditions (Berger and Fetzer, 2019; Somai, 2019, pp. 157-159).

### 3. Economic Criticism Of Economic Nationalism

Various criticisms have been made of economic nationalism in economic theory, supported by practical results. These criticisms generally focus on areas such as economic inefficiency, market distortions, social costs, and the potential for political instability.

#### 3.1. Inefficiency and Misallocation of Resources

- State-supported industrialization efforts can lead to underutilization of production capacities and one-sided heavy industry investments, resulting in failure.
- The state's assumption of the role of "big capitalist and entrepreneur" in economic development can lead to "excessive statism" due to insufficient private sector entrepreneurship.

- The fact that state policies are hostage to internal conflicts (e.g., conflicts between industrial and agricultural groups) prevents the formation of a clear vision for the country's development.
- The disappointment of economic restructuring despite subsidies can lead to weak growth in new businesses and poor policy choices.
- When the duration of protectionist measures is uncertain, national industries may relax their adaptation efforts and lose their competitive edge.
- State interventions can lead to economic inefficiency by disrupting productive links between productive resources and legitimate demand and increasing adjustment costs.
- Economic nationalism prioritizing government preferences beyond maximizing national income can lead to economically suboptimal outcomes.
- An inherent contradiction between industrial policy (targeting specific sectors) and orthodox free trade policy can lead to inconsistent implementation.
- Investments driven by corruption and cost inflation can negatively affect industrial growth.

### **3.2. Market Distortions and Instability:**

- Excessive government spending, loose monetary policies, and weak banking systems can cause financial crises.
- Populist economic nationalism, while emphasizing distribution, ignores the risks to economic stability arising from sharp increases in government spending, inflationary financing, and government interventions that undermine market functioning.
- Monetary instability (which may result from nationalist policies) can create a divisive and cost-increasing effect in cross-border transactions, even threatening the efficiency and survival of capitalism.
- The politicization of macroeconomic policy can erode the credibility of government policies and weaken the commitment to non-inflationary policies, making economic coordination more difficult.
- Nationalism can lead to distortions in corporate laws and merger and acquisition decisions, which can reduce market efficiency.

- Financial nationalism may result in the costs of excessive structural diversity or increased costs of adjusting to external shocks.

### **3.3. Exclusion, Discrimination, and Social Costs:**

- Economic nationalism can be seen as an “excuse” for resource scarcity or a “facade for the collective mindset of the people in the face of real or imagined economic failures.”
- Practices such as “indigenization” and “ethnicization” campaigns may lead to discrimination against national minority entrepreneurs, thereby narrowing the pool of capital and talent.
- The combination of economic nationalism with religious or ethnic ideas can lead to the exclusion of minorities from economic life.
- Boycotts, expropriations, and ultimately massacres targeting Armenian and Greek entrepreneurs in the Ottoman Empire demonstrate that economic nationalism can lead to excessive human and social costs. Such motivations can seriously damage the country’s economic fabric.
- Nationalism has been associated with factors such as deindustrialization, migration, and corruption, and has fueled anti-globalization reactions.

### **3.3. Economic Impacts of Political and Strategic Issues:**

- The intertwining of economic actions with political and even military objectives can lead to suboptimal decisions from an economic perspective.
- The state’s attempts to manage internal social tensions (such as class struggles) by projecting them outward (through geopolitical currency manipulation) can lead to international conflicts or “beggar-thy-neighbor” policies.
- The Yugoslavian experience demonstrates that economic problems are critical for long-term stability in multi-ethnic states. Internal conflicts and accusations of exploitation fueled by economic nationalism contributed to the collapse of the state and instability.
- Drucker argued that globalization has resulted in the “disappearance of the national economy” and that economic nationalism has therefore lost its validity.

### **3.4. Lack of Adaptability and Inappropriateness to the Current Context:**

- Economic nationalism tends to idealize past models when comparing them to today's radically different realities, suggesting that policies may be outdated or unsuitable for current challenges.
- It is argued that state-led development models such as the “Chinese model” cannot be applied to other developing countries due to China's unique characteristics, such as its size, domestic market, Communist Party control, and mix of capitalist and planning features. Furthermore, it is noted that this model is highly vulnerable to collapse from political, economic, and environmental sources.
- Economic nationalism in developing countries may fail to achieve development if it does not address fundamental social and institutional weaknesses.

These criticisms point to the fact that economic nationalism can often jeopardize economic efficiency, stability, and social cohesion in the pursuit of national power and identity goals.

## **4. Conclusion**

The concepts of economic sovereignty, economic nationalism, and trade wars examined in this study provide a comprehensive theoretical framework for understanding the US-China rivalry, one of the most defining international phenomena of our time. The analyses reveal that this rivalry is too deep and multi-layered to be explained solely by superficial economic indicators such as trade deficits or allegations of unfair competition.

The pursuit of economic sovereignty is a fundamental motivating factor behind the policies of both countries. Despite the interdependence brought about by globalization, both the US and China aim to increase self-sufficiency and the capacity to act independently of external interventions in strategic sectors (particularly technology, energy, and supply chains). This situation demonstrates that economic sovereignty has not disappeared in the age of globalization; rather, it has been reshaped, gaining new dimensions such as technological and digital sovereignty.

Economic nationalism emerges as the ideological and political expression of this quest for sovereignty. The US's “America First” policy and China's “Chinese Dream” vision are powerful examples of national interests and identities driving economic policies. These approaches encompass not only protectionist trade measures but also strategies such as creating national

champions, seizing technological leadership, and controlling critical infrastructure. However, as the article also points out, these nationalist policies carry significant risks, including inefficiency, market distortions, and international instability.

Examining trade wars from Realist and Constructivist perspectives has shed light on two fundamental dynamics of the US-China conflict. From a Realist perspective, this war is a classic power transition scenario in which a rising power challenges the existing hegemonic power, and the struggle for relative gains is central. The Constructivist perspective, on the other hand, reveals why and how this struggle was labeled a “trade war,” how the perception of “threat” and the discourse of “unfair competition” were socially constructed, and how national identities and normative claims played a central role in this process.

The US-China trade war is the most concrete example of the resurgence of economic nationalism and the transformation of the understanding of economic sovereignty in the 21st century. This conflict tests the norms and institutions of the liberal international order and shows how the power struggles of states are intertwined with the search for identity and legitimacy. The future course of this competition has the potential to shape not only the economies of the two countries, but also the future of the global trade regime, international cooperation mechanisms, and the world order.

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## Surviving in the Age of Economic Nationalism: The Price of Protectionism and Neo- Mercantilism

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### Abstract

There has always been a conflict between two types of economic mentality: free-market vs. command economy. It is actually the reflection of two broader mind-sets in economic reality: moderate-democrat mentality vs. radical-autocratic mentality. Free market system requires individual decision-making, free trade, no government intervention. Command economy system requires collective decision-making, protectionism and heavy government intervention. Recent trade wars launched by the US Administration against China and other countries is nothing but the latest effort revive the mercantilist, protectionist, anti-free trade and open borders mentality. But protectionism brings high costs, lower supply, higher prices, lower welfare, and fewer alternatives for individuals.

### 1. Introduction

US President Donald Trump and his administration waged a trade war against China and some other leading trade partners in the early days of April 2025. Accordingly, 10 percent base tariffs against Chinese products determined in the beginning of February 2025 were suddenly raised escalating gradually in a few days to reach 34%, 54%, 105% and as high as 145% in certain products! The leaders of China, in response, announced that they will retaliate and raise their tariffs against imported goods from the US, and they did.<sup>2</sup> This is nothing but a trade war in the form of a renewed

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2 For details, see <https://www.aa.com.tr/tr/dunya/cin-trumpin-tarife-artisina-karsi-abdye-yuzde-34-ck-gumruk-vergisi-getirecek/3528174> ; <https://mukellef.co/blog/abd-yeni-gumruk-vergisi-oranlari/>

wave of US tariffs disrupting trade across Asia, compelling China to pursue new trade partnerships and forcing regional economies to recalibrate their growth strategies. As the region absorbs the fallout of tariffs, capital flight and security flashpoints, governments and corporates alike are adjusting course amid widespread uncertainty (EIU, 2025).

What do all these mean in terms of economic policy, development policy, trade policy and economic mentality on an upper level?

No doubt that these are typical indicators of economic nationalism, protectionism, anti-free trade and anti-open border policies. In other words, as the recent trade war launched by the US Administration against China and some other trade partners including the EU, Canada, Mexico, India and Brazil highlights, we are living in an age economic nationalism characterized by populism, protectionism, and neo-mercantilism. Populist leaders and political movements are on the rise everywhere: America, Europe, and Asia. Populist charismatic leaders are coming to power and advocating protectionist, neo-mercantilist, statist economic policies. The most visible example of this tendency is the Trump administration that has come to power for second term recently in the United States.

Populist and protectionist leaders and governments argue that they implement protectionist economic policies characterized by high tariffs, import quotas, import bans and other trade barriers to protect domestic industries and their people against the destructive consequences of free trade and imported goods from abroad. However, instead of taking it for granted, it is important to question the validity of this argument. Can we really protect people and domestic industries by protectionism, high tariffs and other trade barriers? What will happen to the volume of supply, product variety, quality and prices as a result of protectionist policies? In other words, what is the price of protectionism and economic nationalism?

In light of the above, the purpose of this paper is to critically evaluate the main characteristics of economic nationalism, mercantilism and free trade vs. protectionism. The rest of the paper is organized as follows.

In the following chapter mercantilism as a form of economic nationalism is discussed. Basic mercantilist ideas are introduced and criticized. Chapter 3 discusses the main arguments for and arguments against free trade as well as protectionism. The final section concludes with a summary and highlights the price of protectionism.

## 2. Mercantilism as a Form of Economic Nationalism

Human beings attach meaning to life, observe, understand and interpret the reality through basically two types of lenses, which is called mentality. For practical reasons, I would call these mind-sets “moderate-democrat mentality” and “radical-autocrat mentality.” The first one is based on freedom, negotiation, de-centralization, individualism, plurality, variety, and accordingly, giving men a right to choose among alternatives. On the contrary, the second one is based on prohibition, imposition, authoritarianism, centralization, collectivism, uniformity, hence giving men no alternative to choose from. The motto summarizing the philosophy of the latter would be “either my way, or no way!”

These mentalities, as would be expected, have their projections or reflections on economic reality as well. Accordingly, there are two types of economic mentality or mindset: free market vs. command. The main pillars of free market-oriented mentality are private property, freedom of choice and entrepreneurship, individual decision-making, competition, free trade, and no government intervention. On the contrary, the main pillars of command economy-oriented mindset are public property, collective decision-making, central planning, heavy government control and market intervention, and protectionism. In other words, there are two main economic policies with regard to international trade: open borders and free trade vs. closed borders and protectionism.

These two mindsets or mentalities have always been in conflict throughout the history for centuries as depicted clearly and eloquently by Skousen (2014). On one side, there are free marketers supporting Adam Smith type of free markets, open borders, minimal government intervention and free trade. On the other side, there are command-economy proponents supporting central planning, collective decision-making, heavy government intervention, and protectionism.

Looking at the debate of free trade vs. protectionism from an economic history point of view, anti-free trade or protectionist policies were most systematically promoted by the Mercantilists. Mercantilism, sometimes implemented in the form of Cameralism and Colbertism, dominated economic sphere in 16<sup>th</sup> and 17<sup>th</sup> centuries. Today’s protectionist and anti-free trade policies are in essence the revival of mercantilist mindset, hence can be called neo-mercantilism. It is important, therefore, to remember the basic propositions of Mercantilism.

There are three basic propositions of Mercantilism:

- i. **The source of wealth:** It is the stock of precious metals, i.e. gold and silver.
- ii. **The volume of wealth:** Total wealth in the world is fixed.
- iii. **Zero-sum game:** Foreign trade is a zero-sum game.

Implications of this mentality in the realm of government economic policies and international trade are obvious: Since gold and silver are the only source of wealth, hence power, it is OK to capture the gold and silver stock of others, hence legitimizing pillage, booty, colonization and exploitation. Since total wealth of the world is fixed, one can get richer only at the expense of impoverishment of others. According to this mentality it was impossible for both sides to get rich simultaneously. In order for one side to get rich, the other side had to get poorer. Lastly, the mercantilist mindset considered international trade as a zero-sum game, implying that the gain of one side means the loss of the other side, giving zero when you sum them up.

Marking a corner stone in the history of economic thought, Adam Smith (1723-1790), the founding father of modern economics, rejected all of these mercantilist propositions discussed above, and proposed the following:

- i. **The source of wealth** is not gold or silver, but the production capacity of a nation.
- ii. **Total wealth is not fixed**; it can be created, and increased. Therefore, one's getting rich does not have to be at the expense of making someone else poorer.
- iii. **Positive-sum game:** Foreign trade is a positive-sum game; both parties gain from a voluntary exchange.

Obviously, the mentality, mindset, perspective, or point of view of Adam Smith was totally different from the Mercantilist one.<sup>3</sup> The source of the wealth of a nation was not gold and silver stocks, but the production capacity of a nation created by using the productive resources like labor,

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3 Unfortunately, the contribution of the Muslim thinkers and scholars to the free market oriented economic policies are mostly underestimated if not totally ignored. Ibn Khaldun (1332-1406), a Muslim thinker of the 14th century argued for less taxes, minimal government intervention and free markets long before Smith and other Western thinkers (Khalidun, 2015). The Muqaddimah is the most important Islamic history of the pre-modern world. Written by the great fourteenth-century Muslim scholar Ibn Khaldûn, this monumental work established the foundations of several fields of knowledge, including the philosophy of history, sociology, ethnography, and economics. <https://www.amazon.com/Muqaddimah-Introduction-Abridged-Princeton-Classics/dp/0691166285>

land, natural resources, and capital. Since the amount and productivity of the factors of production are not fixed, total wealth was not fixed as well. It could be created and increased through division of labor, which leads to specialization, and increasing productivity. This meant that increasing one's wealth does not have to be at the expense of reducing the wealth of someone else.

Moreover, international trade, contrary to what the Mercantilists argued, was not a zero-sum game. It was a positive-sum game where both sides gained from trade. According to Smith, in order for a voluntary exchange to take place, both sides have to believe that they will gain something from that exchange, otherwise it would not take place at the first place. Smith argued that a country can specialize on those products it has “absolute advantage” (i.e. can produce at a cheaper cost) and gain from free trade (Smith, 2022 [1776]).

This new way of thinking, the new mindset opened the doors a whole new world which was later called “free-market system” based on free trade, freedom of choice and entrepreneurship and no government intervention.

David Ricardo (1772-1823) further extended Smith's theory of “absolute advantages” and argued that even when a country has absolute advantage in both commodities, there is still room for gains from free trade for both sides as long as division of labor and specialization is done according to “comparative advantages” (Ricardo, 2001[1817]). Ricardo's theory of comparative advantages became the dominant theory explaining international trade later on.

As it should be clear by now, there are basically two types of policies with regard to international trade: free trade policy versus protectionism. One can argue that Mercantilists paved the road to protectionism and the Classical-liberal school of macroeconomic thought paved the way to free trade. The following section discusses the basic arguments for and against free trade, as well as arguments for and against protectionism. Once again, this debate is not something that belonged to history, or something outdated. On the contrary, the debates on free trade and protectionism has always been a hot debate in all ages, all countries, all political parties, academics, leftists and the right-wings alike. It is still a hot topic today. The Trump Administration's trade war against China and some other countries is nothing but the revival or the ghost of mercantilist mentality and economic nationalism.

### 3. Free trade vs. Protectionism

As mentioned above, debates on free trade vs. protectionism have a long history, which date centuries back. It is not independent from the general mindset on how to deal with economic reality, how to organize economic activities, how to create wealth, and what should be the role of government in all these, etc. One can see supporters of protectionists as well as supporters of free traders in all countries and all ages with no exception, including today. As would be expected, supporters of both views put forward certain arguments and justifications in regards to why they support the view they adopted. Some of these arguments are discussed below.<sup>4</sup>

#### 3.1. Arguments for Protectionism

##### 3.1.1. National security

The most widely used argument for protectionism has been national security. For those who advocate protectionism, national security can best be achieved through protectionist policies. Import means dependence on foreign countries. When international relations get stuck with high tension or conflict, national security falls in danger, so it is better not to be dependent on imports, but produce the products you need domestically.

##### 3.1.2. Self-sufficiency (autarky)

Very parallel to the national security argument, supporters of protectionism attach high importance to self-sufficiency or autarky. For them a country should be able to feed its population, should be able produce whatever it needs, and should not be dependent on anyone.

##### 3.1.3. Infant industry

According to protectionists, domestic infant industries should be protected against foreign competition until they grow up and rely on their own feet, because they cannot survive otherwise. In the early stages of their development they are weak and vulnerable, hence need protection. Trade barriers can be relaxed later on when they grow and get strong enough to face with the foreign competition.

##### 3.1.4. Reducing unemployment

One of the most popular arguments for protectionism is reducing unemployment. For protectionists, allowing foreign goods coming into

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<sup>4</sup> For a more detailed discussion, see Acar (2018, pp. 81-118), Roberts (2021).

the domestic market means reduced demand for domestic products, which eventually lead to contraction of the domestic industries. Some of the contracting firms will have to lay off some of their workers, leading to higher unemployment. Therefore, restricting imports through trade barriers like customs duties, quotas, import bans etc. will help promote demand for domestic products, hence increasing employment and reducing unemployment.

### **3.1.5. Anti-dumping**

According to anti-dumping argument, foreign companies frequently offer their products at a price below their costs (i.e. dumping), hence forcing domestic firms to bankrupt or exit the market. Therefore, the government should impose “anti-dumping” duties on foreign firms to protect domestic firms to survive.

### **3.1.6. Reducing balance of payments deficits**

Another argument for protectionism is increasing tax revenues of the government treasury via tariffs, hence reducing balance of payments (BOP) deficits. Many countries have BOP deficits, so reducing imports through high tariffs would reduce these deficits.

### **3.1.7. Fair trade: equality of conditions**

Another fantastic, confusing argument for protectionism that sounds good at a first glance is the fair trade argument. It underlines the importance of “equality of conditions,” and concludes that since conditions are not equal between countries, government policies, natural conditions as well as market conditions faced by different firms, the national firms should be protected by government until the conditions become equal.

### **3.1.8. Environmental protection**

Protectionists especially from developed countries frequently argue that underdeveloped countries use primitive “dirty technologies” that pollute the environment. Hence government of the developed countries should punish them by raising the trade barriers against the products coming from underdeveloped countries using dirty technologies and creating environmental pollution.

### 3.1.9. Child labor

Another argument raised by protectionists from the developed countries that sound human and merciful at a first glance is child labor argument. They argue that many developing countries use child labor to produce cheaper products and get cost advantage against developed country products. The developed countries should punish those countries using child labor and ask for occupational health safety.

### 3.1.10. National market for domestic producers

Last but not least, is the argument demanding national market to be restricted to domestic producers. As a typical nationalistic argument, it proposes that the national market is the natural home for domestic producers, hence domestic firms should be granted to act comfortably in the domestic market by keeping foreign firms out of the market. This type of nationalistic thinking may go all the way down to teaching elementary school students that everybody should consume domestic products.<sup>5</sup>

## 3.2. Arguments for Free Trade

As for the free traders, they criticize all the protectionist arguments showing that they are not as valid or strong as they might seem to be at a first glance, and put forward certain arguments in defense of free trade as discussed below.

### 3.2.1. National security cannot be guaranteed by protectionism

According to free traders, national security cannot be guaranteed or achieved by protectionism basically for three reasons. First, it has to do with nuclear power, space technology, sophisticated weapons, etc. Imposing trade barriers to restrict imports does not help achieve national security. Second, in today's world almost all products, including the most strategic weapons, are produced by different countries across the world. Once you have the money, you can get whatever need from another supplier even in the hard times when the international political tension is high.

Third, and most importantly, what guarantees national security is to prevent war, and establish peace which can best be achieved by free trade,

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5 We used to celebrate “domestic goods week” where our teachers ask us to repeat the dictum “yerli mali yurdun mali, herkes onu kullanmalı,” meaning “domestic products are our motherland’s product, hence everyone should use them.” This is a typical nationalist slogan preaching to prefer domestic products regardless of price and quality, something worthless from a rational economic point of view.

not protectionism. One of the most important advantages of free trade is it helps establish friendly relations between nations, reducing the possibility to go into war. Once a country starts to export to and import goods from another nation, people across the borders starts earning money, find jobs, get better off economically, hence develop friendly relations. This reduces the possibility of a conflict, clash or confrontation between the trade partners. This fact can easily be confirmed by taking into account the fact that those countries which established free trade zones between themselves do not wage war against one another, the EU member states being the most visible example. As stated by Frederic Bastiat centuries ago, “if you do not allow goods to cross borders, soldiers will cross them” (Bastiat, 1997). This is a fantastic way of underlying the importance of free trade in sharing the scarce resources in a peaceful, moral, and humanitarian way.

### **3.2.2. Self-sufficiency is the road to poverty**

As elaborated by Roberts (2021) very convincingly, self-sufficiency is the road to poverty. This stems from the simple fact that no country in the world can have comparative advantages in all industries, in all products at every level. Because natural resources as well as human resources are not distributed evenly in the world. Geographical, climatic, sociological, natural, historical, and technological conditions are all different. Some countries have rich natural resources, oil and gas reserves whereas some are rich in terms of young population, some have advantages in terms of strategic geographical locations. These factors lead to a world where every country might have a comparative advantage on certain industries, products, or fields, but not all at the same time.

Self-sufficiency simply means trying to produce everything you need by yourself. Economically, it is either impossible, or could be possible but at a much higher cost, both at individual and national level. For example, none of us produces the wheat as the raw material of the bread and bakery products we consume. Likewise, nobody produces the shirt he/she wears which is produced out of fabric, of which produced out of cotton, etc. They are all produced by the farmers, firms or bakeries where we as consumers simply buy the final products from where they are sold. This means that none of us is self-sufficient, we all depend on one another. This is true for countries as well. Instead of trying to produce everything, it is much better and cheaper to specialize on something we have comparative advantage and buy other things from more efficient producers.

### **3.2.3. Infant industries never grow**

The counter argument by free traders against the infant industry argument is that infant industries never grow and become self-reliant as long as they are protected unconditionally. It would be acceptable to support some domestic infant industries at their early stages; but it should be temporary and conditional on satisfying certain conditions within a certain time limit. Otherwise they prefer to go after rent-seeking and some crony relations with politicians and decision-makers to guarantee the continuation of the existing protections forever.

In other words, just like swimming cannot be learned without diving into waters, competition can best be learned under competitive conditions. If you want domestic infant industries to grow and learn how to compete with foreign firms, you have to allow foreign competition and let the domestic firms to face it.

A good example of this fact can be given from Turkish automotive industry. From 1950s until 1990s the automobile industry was protected in Türkiye by the governments unconditionally. It was impossible to import one single automobile throughout more than four decades. The result was terrible: Turkey was unable to export one single automobile, and Turkish people had to wait for a long time after making payments in advance to get one of the lowest quality autos in the world with no air brake system, or no automatic transmission. Once Türkiye had “customs union” with the EU in industrial products in mid-1990s, Turkish firms had to renew their technology very quickly and started to produce and export higher quality automobiles to all over the world.

### **3.2.4. Protectionism does not prevent unemployment, just relocates**

Contrary to what protectionists argue, protectionism does not reduce or prevent unemployment but just relocates between different industries. This stems from the simple fact that international trade is like a two-way road: goods and services go abroad in one (exports), and they come from the other side (imports) (Roberts, 2021). Once a country starts imposing trade restrictions against a trade partner, that country is likely to retaliate; just like China did in response to tariff increases by Trump Administration in early April 2025. As a result, a contraction in export industries becomes inevitable, hence job losses come out. This means that while a country tries to increase employment in import-substituting industries, employment losses arise in export industries. In the end, there would not be a reduction

in unemployment but just a relocation of the unemployed between various sectors, i.e. unemployment moving from import-substituting to export industries.

### **3.2.5. Anti-dumping cases are implicit demand for protectionism**

At a first glance, calls for anti-dumping sounds fair, because foreign firms seem to try to kick domestic firms out of the market by selling their products at a price below their cost. But in reality, we have a different picture than claimed. These claims are based on the assumption that the cost of the foreign firms is the same with that of the domestic firms, which is not true in most cases. Labor cost in China for example is much cheaper than the US and the EU. Likewise, input prices are not the same everywhere, just like the transportation costs. Therefore, it is quite possible that what is “below the cost” for a (foreign) firm, may quite possibly above the cost for another (domestic) firm as indicated by practical cases (Roberts, 2021, Bovard, 1992). Under these circumstances, anti-dumping argument also collapses.

### **3.2.6. Protectionism does not improve balance of payments (BOP) deficits**

The counter-argument raised by the free-traders against the protectionist is that protectionism does not reduce BOP deficits. Since restricting imports would negatively affect export industries through retaliations, there would not be a considerable improvement in external deficits position of a country. On the contrary, a country can more effectively improve its BOP deficits by promoting free trade, increasing merchandise exports and tourism industries which help increase a country's foreign exchange earnings.

### **3.2.7. Faire trade is a fallacy: what creates trade is inequality of conditions**

Perhaps the most interesting and confusing argument by the protectionists that sounds good at a first glance but a total fallacy in reality is the fair trade argument. This is because, inequality of conditions between countries is a natural phenomenon, mostly going beyond human control. Natural, geographical, climatic, technological, physical and social conditions are different across the world. More importantly, it is basically this difference that makes international trade possible, plausible, and profitable. Consider for a moment that if all natural, geographical, technological, and social conditions were the same for all countries all over the world, there would not be any room for trade, because costs and hence prices would be the same everywhere. Why should then a country buy a product from another country

where it has the same product with the same price? Even though this is a so obvious fact, yet this argument is raised by protectionists at political and ideological grounds. Bovard (1992) seems right when he calls it “fair trade fraud,” where he shows that actually politicians pillage the consumer and decimate the competitiveness of the private industries when calling so called “fair trade.”

### **3.2.8. Free trade is not the cause of environmental pollution**

This is another weak argument for protectionism that could be easily debunked. All plausible sources on climate change and environmental protection, including Kyoto Protocol and Paris Climate Summit, indicate that the bulk of the carbon emissions polluting the environment have been released by the developed countries. The most recent data show that developed countries such as the US, Japan and Russia are among the top-five polluters (Worldometer, 2025). It is interesting to remember that the US, one of the biggest polluter of the environment at the global level, resisted not to sign the Kyoto Protocol for a long time. Furthermore, once we think about the history of the accumulation of air pollution since the industrial revolution, this argument becomes invalid.<sup>6</sup>

### **3.2.9. Child labor can be prevented by free trade**

Another unconvincing argument for protectionism is the argument criticizing the use of child labor in underdeveloped countries. First of all, no responsible parent would force their under age children to work. It is a necessity for children in many developing countries to work and contribute to family budget. Furthermore, free trade is the safest way for many underdeveloped countries to reduce poverty and provide their population better living conditions. In other words, if we really care for the children of the developing countries, we should promote free trade policies so that these countries grow faster, achieve economic development, improve the living conditions for all, and hence children do not have to work and enjoy their time playing and studying.

### **3.2.10. Free trade reduces prices**

One of the most visible positive consequences of free trade is it reduces prices hence suppress inflationary tendencies by increasing supply and promoting competition. When goods and services are allowed to cross

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6 The record of socialist and centrally planned economies is much worse than the free market economies in terms of environmental pollution. More discussion on free market capitalism and environmental protection can be found in Zitelmann (2023).

borders, total supply of goods will increase, pushing prices down as proposed by the law of supply and demand: *ceteris paribus*, prices will go up as demand goes up (i.e. scarcity), and prices will go down when supply goes up (i.e. bounty). Similarly, increasing competition will contract the profit margin. In other words, free trade will suppress the inflationary tendencies and will allow people to enjoy goods and services at a cheaper price. This is good for all, especially those people who have a limited and fixed income.

### **3.2.11. Free trade increases quality and variety**

Equally important, free trade brings competition, which not only lead to cheaper products but also increasing quality and product variety. Competition forces competing firms to use resources efficiently, and increase quality. New products will be developed through R&D by the competing firms. On the contrary, when there is no free trade and hence no competition, there will be monopolistic or oligopolistic conditions dominating the market, reducing total supply, lowering the quality and variety of the products.

### **3.2.12. Free trade reduces rent-seeking and corruption**

When there is competition, open borders and free trade, there will be less room for corruption, bribery and all other illegal, unlawful irregularities. Economically, when there is a ban, prohibition or restriction in an industry (related with production, distribution, investments and trade, etc.), there will be rents created by the higher prices than it would be otherwise. Capturing, sharing or distribution of these rents between politicians and private firms will be a big, critical, sensitive issue. Existing firms protected from foreign competition by government regulations and trade restrictions will be ready to offer some of those accumulating rents as bribery to guarantee the continuation of the protection. Obviously, rent-seeking and corruption at administrative levels are inevitable in an economy where import bans, high tariffs and all sorts of trade restrictions.<sup>7</sup> Protectionism is the natural home for rent-seeking and corruption which kills the good governance.

### **3.2.13. Free trade increases welfare, reduces poverty**

One of the strongest arguments for free trade in material sense is the fact that free trade increases welfare and reduces poverty. In fact, this is a compound effect of what we mentioned above: increasing total supply, reducing prices, bringing higher quality and more variety. Combined with faster real economic growth possibility for the economy in general, free

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7 See Krueger (1974) for a detailed discussion on the political economy of the rent-seeking.

trade increases welfare and alleviates poverty. Increasing welfare makes life better for all, especially ordinary citizens with limited and fixed income. This is material gains from free trade. But the story does not end here.

Perhaps many people may not see it easily, but there are immaterial benefits of free trade as well, which bring us to the last item below: the moral superiority of free trade.

### **3.2.14. Free trade is morally superior, too**

It must be more than obvious by now that free trade is much superior to protectionism on material grounds. It means faster growth, higher quality products, cheaper prices, more variety, higher welfare, less rent-seeking and less corruption. But what about the superiority of free trade over protectionism on immaterial, or moral grounds? This is something many people overlook. However, the moral superiority of free trade over protectionism is as important as its material superiority. For us, moral superiority is no doubt much more important.

As elaborated by Roberts (2021) and Griswold (2002) very well, free trade is superior to protectionism on moral grounds in many respects: it brings more alternatives before individuals in every sense (better alternatives for career, health, education, profession, going abroad, enjoying worldly facilities, etc), respecting the dignity and sovereignty of the individual, restraining the power of the state, encouraging individuals to develop moral virtues, bringing people across distance and cultures, encouraging both basic human rights (e.g. freedom of speech and religion), fostering peace by raising the cost of war, feeding and clothing the poor.

In light of the above discussion, one can foresee that the trade wars waged by the US Administration against China and some other trade partners recently would bring no positive consequences, neither American people, nor American economy and the world. On the contrary, protectionism implemented by exploiting nationalistic feelings and fears from globalization with no sound base is nothing but shoot oneself in the foot. It will bring detrimental outcomes for the poor, ordinary people, men on the street, people with limited income. It will bring detrimental consequences for American firms as well by preventing competition, negatively affecting motivation to improve technology, quality and product variety, and push for rent-seeking and corruption.

#### 4. Conclusion

We are living in an age of economic nationalism and populism where protectionism and populist political leaders and movements are on the rise all over the world. The most visible example of protectionism and economic nationalism is the trade war waged recently by President Trump and the US administration. This is nothing but a revival of neo-mercantilism arguing for high tariffs, import bans, quotas and all other trade restrictions.

In fact, economic nationalism and protectionism is the reflection of the “radical-autocratic mentality” on a higher-philosophical level based on authoritarianism, big government and government intervention, centralization, central planning, collectivism, uniformity, prohibitionism, closed borders and self-sufficiency. The more plausible alternative to this is “moderate-democrat mentality” based on individualism, freedom, individual decision-making, open borders, free trade, de-centralization, pluralism, and globalization.

As such there has always been a tension, conflict and friction between these two mentalities. Debates on free trade vs. protectionism is just a reflection of these mindsets on economic reality. In this regard debates on free trade and protectionism has a long history and one can find free traders as well as protectionists everywhere, in all ages, all countries in all continents among politicians, decision-makers, bureaucrats, academics as well as the laymen.

There are a number of arguments for protectionism, fed by the nationalistic feelings most of the time, which sounds good and impressive at a first glance. Among these arguments are national security, autarky, infant industry, reducing unemployment, preventing child labor, environmental protection, fair trade.

However, free traders have even stronger arguments against protectionism and for supporting free trade. After critically evaluating those arguments for protectionism and showing that they are not confirmed by reality, they put forward a number of arguments for free trade. This author, who spent almost forty years on thinking, discussing and doing research on these issues, wholeheartedly believe that free trade policies are much superior and convincing. The superiority of free trade against protectionism is not limited to material grounds in the form of higher welfare, faster economic growth, higher trade volumes and higher income per capita. The free trade policies are superior to protectionist policies in moral grounds, too. They promote peace, stability, self-realization, individual development, developing trust

and higher moral values, more cultivating friendly relations among nations, and increasing the alternatives before individuals to choose from in every sense.

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## Tariffs And Trade Wars: The Rise of Protectionism in The Global Economy

Fatma Pınar Eşsiz<sup>1</sup>

### Abstract

Over the past two decades, international trade has undergone a significant transformation shaped by political, strategic, and structural shifts in the global economy. Once viewed primarily as a vehicle for economic growth under the paradigm of globalization, trade is now increasingly used as a tool of geopolitical influence and state power.

This chapter explores the growing protectionist turn in global trade policy since the 2010s, through the lens of new mercantilism. From the United States' tariff-driven confrontation with China to Russia-related sanctions, India's agricultural trade barriers, and the EU's climate-oriented carbon border adjustment mechanism, trade policies are being strategically redefined beyond purely economic goals. These changes are deeply rooted in structural dynamics such as rising inequality, deindustrialization, job losses from technological change, and anti-immigration pressures.

Unlike classical protectionism, this new wave incorporates indirect trade barriers justified by environmental, security, and employment concerns. The chapter offers a theoretical and analytical framework for understanding how global trade is shifting away from multilateral liberalism toward nationally driven economic strategies. By connecting these developments within a coherent causal chain, the study aims to provide an original contribution to the literature on the political economy of global trade.

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## 1. Introduction: The New Face of Foreign Trade

At the beginning of the 21st century, world trade experienced a golden age thanks to the opportunities offered by globalization. However, developments in recent years have begun to reverse this picture. Today, trade is no longer an economic activity limited to the flow of goods across borders; it has also become an integral part of international relations, geopolitical tensions, and strategic interests. Sometimes used as a bargaining chip and sometimes as a direct instrument of sanctions, trade has emerged as one of the most effective tools in power struggles between states.

In this new era, policies such as tariffs, import quotas, embargoes, export controls, and technology bans are shaped not only by economic considerations but also by strategic decisions. Examples such as US tariffs on China, trade sanctions against Russia, India's protective tariffs on agricultural products, and the European Union's carbon border adjustment mechanism clearly demonstrate that trade is now being used for multiple policy aims.

Since the 2010s in particular, inward-looking and populist discourses have gained strength in many countries, paving the way for the rise of protectionist tendencies in trade policy. In the United States, Donald Trump's "America First" policy not only led to higher tariffs but also undermined confidence in the global free trade system. The renegotiation of the North American Free Trade Agreement (NAFTA) into the United States-Mexico-Canada Agreement (USMCA), alongside tariffs and technology restrictions targeting China, exemplify this transformation (Saliya, 2025: 1). Similar trends are observed in Europe. Brexit can be interpreted as the materialization of the United Kingdom's criticism not only of political union but also of economic integration. This process can be seen as a symbolic example of "globalization clashing with the local" (Colantone & Stanig, 2018).

Behind these policies lie dynamics such as deepening socio-economic inequalities, anti-immigrant sentiment, deindustrialization, and unemployment caused by technological transformation. In this context, "new protectionism" stands out as a more comprehensive approach that is not limited to traditional tariffs and import quotas, but also includes indirect trade barriers justified on the grounds of environmental protection, national security, technology transfer, and employment. Hence, this new wave of protectionism is not purely economic; it is also part of a quest for social and political legitimacy (Bremmer, 2014). This chapter examines the new paradigm in which the global economy is shifting away from multilateral free trade toward protectionist tendencies. The contribution of the study lies both in the causal chain it constructs among these phenomena and in the

systematic integration of these dynamics with the conceptualization of “new mercantilism.”

## 2. The Hegemony of the Neoliberal Era and the Crisis: The Rise of Protectionism

Since the late 20th century, when globalization gained momentum, international trade has become not only a key driver of economic growth but also a cornerstone of the global order. Especially after the end of the Cold War, the spread of free-market ideology worldwide encouraged trade liberalization and enabled nation-states to establish relations based on mutual economic interdependence (Fukuyama, 1992). However, developments in the 21st century have shaken this approach. Economic nationalism, geopolitical tensions, and technological transformation have shown that trade is not merely a process of production and consumption; it can also be used as a tool of political pressure and strategic influence (Rodrik, 2011; Farrell & Newman, 2019).

This transformation has prompted states to reconsider and recalibrate their trade policies on a more defensive footing. Tariffs, export bans, protection of strategic sectors, restrictions on technology transfer, and economic sanctions have become integral elements of foreign policy (Hopewell, 2021). For example, US sanctions against Chinese technology companies such as Huawei and ByteDance (the owner of TikTok), as well as the EU's carbon border adjustment mechanisms, clearly demonstrate how trade regulation grounded in environmental and security concerns has become strategic.

In this context, trade has become a geopolitical issue—an “economic battlefield” where states can advance their interests through economic means (Blackwill & Harris, 2016: 219–220). This change has also led to a redefinition of the concept of economic security. Strategic vulnerabilities in supply chains, the control of high-tech products such as microchips, and access to critical raw materials have expanded the security agendas of nation-states and shifted political economy relations onto a security axis (Allison, 2017). In this framework, trade is no longer solely a mechanism that fosters interdependence and peace, as envisioned in classical liberal theories; it has also become a new front in hegemonic power struggles and regional rivalries. Accordingly, this section first explains the return of national priorities and then discusses the concept of geoeconomic security.

## 2.1. “My Country First”: The Return of National Priorities

In the last quarter of the 20th century, particularly after 1980, the neoliberal economic approach became the dominant paradigm worldwide. Shaped under the leadership of US President Ronald Reagan and UK Prime Minister Margaret Thatcher, principles such as the free market, global integration, and limited state intervention constituted the basic policy framework (Harvey, 2005: 1–4). The establishment of the World Trade Organization (WTO) in 1995 and China’s accession in 2001 fostered the institutionalization and deepening of global trade; foreign trade was seen as the engine of growth.

However, the 2008 Global Financial Crisis caused a serious rupture in neoliberal globalization. Global stagnation, rising inequality, and a weakening middle class led to a reappraisal of market-oriented policies. In the post-crisis period, especially in Western countries, claims that “prosperity does not spread” and that global trade primarily benefits multinational corporations resonated in public and political arenas (Rodrik, 2011; Stiglitz, 2017). From the 2010s onward, increasingly powerful inward-looking and populist discourses heralded a significant transformation in trade policies. This new trend went beyond classical protectionism and took on a more complex structure intertwining economic reflexes with social and political dynamics. In particular, the “America First” rhetoric of the Trump administration not only increased tariffs but also eroded confidence in the multilateral free trade regime (Bown & Irwin, 2019; Saliya, 2025). In this context, the renegotiation of NAFTA into the USMCA, high tariffs on China, sanctions on technology companies such as Huawei, and export controls are among the striking examples of this new protectionism (Evenett, 2020; Hopewell, 2020).

To make sense of new protectionist tendencies, it is necessary to examine both the historical origins of protectionism and its current transformation. Approaches to the concept vary considerably in the literature. While there is no common definition of the term’s scope and content, some common themes emerge: discriminatory practices against foreign economic actors and regulations that restrict foreign trade. The extent to which protectionist measures interfere with market functioning and distort competition is also a complementary dimension often considered (Altenberg, 2016).

The roots of protectionism lie in the mercantilist approach to political economy that emerged in the 16th century. Mercantilism assessed a state’s economic power according to its precious metal reserves and foreign trade surplus; therefore, encouraging exports and restricting imports through

tariffs were adopted as key policy instruments. Within this framework, the state actively intervenes in the economy to increase national capital accumulation.

Today, the wave of protectionism that emerged especially after the 2008 crisis has evolved into a more complex structure that is not limited to classical tariffs and includes technological, strategic, and digital elements. This transformation is described by some as “new mercantilism” or “geoeconomic protectionism” (Bremmer, 2010; Farrell & Newman, 2019; Hopewell, 2020). In this trend, an adaptation of certain assumptions of classical mercantilism to contemporary conditions, the accumulation of precious metals has been replaced by technological superiority, data sovereignty, and control over strategic sectors. States are redefining economic development not only in terms of growth but also in terms of national security, supply chain sovereignty, and strategic autonomy (Luttwak, 1990; Blackwill & Harris, 2016).

Neo-mercantilist policies often aim for long-term interests rather than short-term gains. According to this perspective, the global economy is an arena where one actor’s gains may come at another’s expense. Hence, economic and national interests are intertwined. Strategic resources and supply chains are particularly important. Countries that can maintain technological, market, or resource superiority in certain areas hold advantages. While these areas may be narrower for smaller states, great powers seek broader control (Collins & O’Brien, 2022: 636). In this context, sectors such as semiconductors, artificial intelligence, and green technologies have become the center of global competition, and the goals of reducing foreign dependence and increasing domestic capacity in these areas are now priorities of state policy (Dachs et al., 2025: 754).

Competition in these strategic sectors is not only economic but also geopolitical. The intensifying technological and commercial rivalry between the US and China is among the most visible manifestations of neo-mercantilist policies today. Both countries have implemented extensive state interventions, stimulus packages, and trade restrictions to increase strategic autonomy, gain greater control over global value chains, and retain technological leadership. Another factor steering the US toward these practices is that China accounts for the largest share of the US trade deficit (Koçakoglu & Özyayın, 2020: 639).

Similar protectionist tendencies have manifested themselves in Europe. Brexit made the UK’s criticisms of the EU visible not only politically but also in terms of economic integration and has been evaluated as one

institutional reflection of the anti-globalization discourse (Colantone & Stanig, 2018; Rodrik, 2018). In this context, Brexit can be interpreted as a symbolic manifestation of “globalization’s conflict with the local.” Regional inequalities, immigration, and multiculturalism debates deepened political polarization, leading a significant segment of the British public to distance themselves from global economic integration (Goodwin & Heath, 2016).

The structural factors behind the rise of this new wave of protectionism are not only economic but also socio-political. Welfare losses from globalization for certain social groups, deindustrialization, the disruptive impact of technological change on labor markets, and cultural backlash driven by increasing migration flows provide the social legitimacy for these policies (Rodrik, 2011; Bremmer, 2014). Unemployment in traditional manufacturing centers, the expansion of low-wage services, and deepening inequality facilitate the promotion of exclusionary and protectionist policies, especially among low- and middle-income groups (Autor, Dorn & Hanson, 2016).

In this context, “new protectionism,” unlike classical tariff-based approaches, extends beyond economic interests and reflects a reflex to protect cultural and political identities. Thus, protectionism today is being reconfigured not only as an economic tool but also as an essential component of populist politics and the emphasis on national sovereignty (Norris & Inglehart, 2019).

*Table 1. Free Trade and Protectionism Periods in the World Economy (1500-2025)*

| Years     | Trade Policy Trend |
|-----------|--------------------|
| 1500-1776 | Mercantilism       |
| 1776-1875 | Transition         |
| 1875-1914 | Free               |
| 1914-1944 | War                |
| 1944-1970 | Liberalism         |
| 1970-1980 | Crisis             |
| 1980-2008 | Neo-Liberal        |
| 2008-2018 | Crisis             |
| 2018-     | New Protectionism  |

*Source: Helleiner, 2002; Rodrik, 2011; Baldwin, 2016; Yilmaz and Divani 2018.*

The table above periodizes the historical evolution of free trade and protectionism in the world economy. Protectionist periods dominated

by mercantilism and economic nationalism since the 1500s started to be replaced by free trade tendencies with classical economic thought in the late 18th century. The liberal waves of the late 19th and early 20th centuries enabled the expansion of global trade; however, wars, economic crises, and political polarization brought new protectionist waves. Especially after the 2008 global financial crisis and, from 2018 onward, the escalation of trade wars mark a resurgence of state intervention and economic nationalism.

## **2.2. The Nature of New Mercantilism: Geoeconomic Security and Weaponized Trade**

Mercantilism, practiced from the 16th century until the rise of classical economics, defined national wealth in terms of gold and silver stocks and recommended using trade surpluses to increase state power. Supported by state intervention, protectionism, export incentives, and powerful navies, this system treated trade as a zero-sum game. By the late 18th century, classical economists such as Adam Smith and David Ricardo severely criticized mercantilist thinking and argued that free trade benefits all parties. With these developments, mercantilism receded from prominence until the late 20th century. However, transformations in the global system—especially the conduct of geopolitical competition through economic instruments—have revived mercantilist-style policies adapted to new conditions. In this process, termed neo-mercantilism or new mercantilism, the basic assumptions of classical mercantilism are preserved but linked directly to geoeconomic security and national sovereignty.

In this new era, “mercantilist” policies go beyond the classical accumulationist approach and center on energy, technology, digital infrastructure, data, and supply chains, following a logic of “geoeconomic security.” Geoeconomic security refers to states’ deliberate, systematic use of economic instruments to protect national security and strategic interests. These instruments include trade policies (tariffs, export controls), investment controls (e.g., restrictions on Chinese investment), sanctions, energy dependency management (pipelines, LNG exports), and access to financial infrastructure (e.g., the SWIFT system). The preservation of technological superiority, data security, energy supply, and access to rare earth elements has become more important than traditional export surpluses (Blackwill & Harris, 2016). Economic instruments have become bases for achieving political goals, and discourse on “economic warfare” has become prominent, with economic tools as consequential as military-political instruments (Farrell & Newman, 2019).

Although trade disputes have periodically arisen since antiquity, rising trade tensions and reciprocal tariffs between the US and China in recent years have made the discourse of trade wars more visible globally. Table 2 and Chart 1 provide comparative views of foreign trade interventions implemented between January 2010 and August 2025, the most affected products, and the distribution of interventions by country.

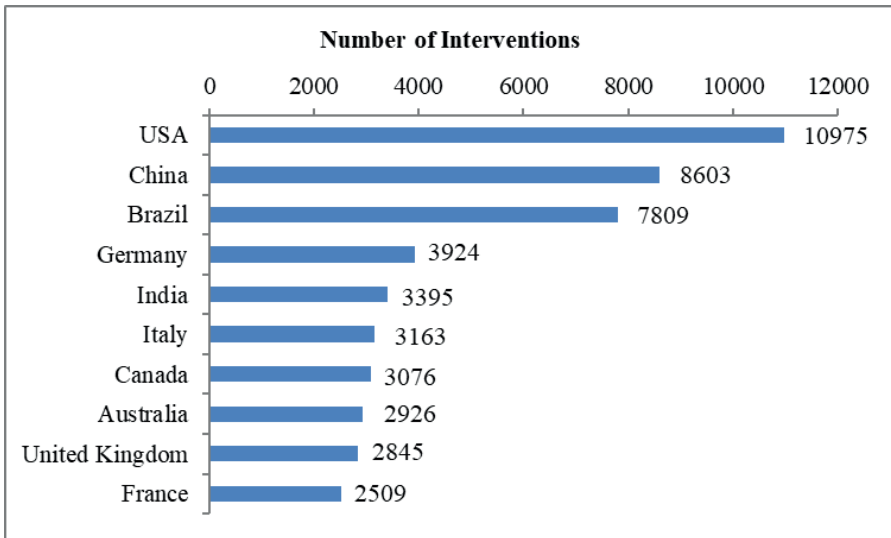
*Table 2. Types of Interventions and Affected Products between January 2010 and August 2025 (Top 10)*

| Intervention Type                          | Number of Interventions | Affected Products                                                                                                                | Number of Interventions |
|--------------------------------------------|-------------------------|----------------------------------------------------------------------------------------------------------------------------------|-------------------------|
| Financial grant                            | 11836                   | Mineral fuels, mineral oils and products of their distillation; bituminous substances; mineral waxes                             | 4413                    |
| Government loan                            | 10873                   | Iron and steel                                                                                                                   | 3957                    |
| Import tariff                              | 8833                    | Plastics and products made from them                                                                                             | 3640                    |
| Trade finance                              | 6219                    | Optical, photographic, cinematographic, measuring, control, medical or surgical instruments and apparatus; parts and accessories | 3493                    |
| Local content incentive                    | 2766                    | Chemical products (not elsewhere classified)                                                                                     | 3093                    |
| Loan guarantee                             | 2238                    | Grain                                                                                                                            | 3074                    |
| Tax or social security deduction           | 2025                    | Organic chemicals                                                                                                                | 2609                    |
| Anti-dumping                               | 1814                    | Inorganic chemicals; organic and inorganic compounds of precious metals; rare earth metals, radioactive elements and isotopes    | 2586                    |
| Financial assistance in the foreign market | 1704                    | Pharmaceutical products                                                                                                          | 2422                    |
| Localization of public procurement         | 1520                    | Animal, vegetable or microbial fats and their breakdown products; prepared edible oils; animal or vegetable waxes                | 2247                    |

*Source: Global Trade Alert, 2025.*

The left panel shows that governments mostly prefer indirect support instruments rather than direct market intervention. The most common type is “financial grants” (11,836). This suggests that governments attempt to increase firms’ competitiveness via direct financial support. Financial grants are followed by government loans (10,873) and import tariffs (8,833). This ranking indicates that both incentive (subsidy) and protective (tariff) policies are used in tandem. Instruments such as trade finance and local content requirements are also widely used, indicating state efforts not only to boost exports but also to increase domestic production and localize supply chains.

*Chart 1. Top 10 Countries with the Most Interventions between January 2010 and August 2025*



*Source: Global Trade Alert, 2025.*

According to the chart, the United States is by far the country with the highest number of interventions (10,975), reflecting its increasing protectionism and strategic use of trade policy instruments. Emerging markets such as China (8,603) and Brazil (7,809) also exhibit high levels of intervention, often to protect domestic industries and build capacity in strategic sectors. Countries such as Germany (3,924), India (3,395), Italy (3,163), Canada (3,076), Australia (2,926), the UK (2,845), and France (2,509) display relatively fewer interventions, but they too adopt interventionist policies at times, especially during crises (e.g., the COVID-19 pandemic or global supply shocks).

In this context, the use of trade as a geostrategic tool has become notable. There are growing concerns that the current structure of international trade creates favorable conditions for using trade as a foreign policy instrument. “Weaponization of trade” refers to the strategic use of trade policy tools by one state to exploit another’s economic vulnerabilities in order to induce changes in the target’s economic, security, or diplomatic behavior. While international trade generally generates welfare gains, it also creates asymmetric interdependence. Such asymmetry can cause one party to incur greater damage than the other if economic relations are suspended, forming the basis for using trade as a coercive mechanism (Feldhaus et al., 2020: 4).

These geoeconomic definitions show that economic instruments can be used not only for market regulation but also directly toward national security objectives. Geoeconomic security explains how economic tools can be deployed as non-military but coercive strategies. In this framework, the use of economic interdependence—especially among great powers—has brought the concept of “weaponized trade” to the fore. This concept differs from “trade war,” which typically refers to the intensive use of trade instruments, especially tariffs, to achieve economic gains (e.g., improving the terms of trade). Weaponization of trade entails instrumentalizing trade policy to change the target country’s behavior not only economically but also in security or diplomatic realms. For example, as in the 1973 Oil Embargo, trade can be used as a direct coercive instrument to reshape a country’s security alliances (Feldhaus et al., 2020: 4). Harding and Harding (2017) argue that trade has evolved from being an implicit instrument of coercion to an explicit tool for achieving foreign policy objectives.

Although geoeconomic strategies and protectionist policies can protect national interests and manage dependencies in the short term, their long-term sustainability is debated. Rising global protectionism is likely to have extensive, multidimensional impacts on consumers, producers, governments, investment decisions, and trade flows. In particular, higher tariffs raise the prices of imported goods, weaken consumers’ purchasing power, and limit market access. The literature indicates that tariffs disproportionately affect low-income households, as these groups must allocate a larger share of income to basic consumption. Moreover, higher prices for imported intermediates encourage firms to source domestically at higher cost, increasing the likelihood that cost increases are passed on to final consumers. These developments affect firms’ employment policies and may lead to changes in wage levels (Kutlina-Dimitrova & Lakatos, 2017: 2). This, in turn, raises concerns about the adverse effects of protectionism on social justice and income distribution.

In sum, new mercantilism reintroduces the classical tendency to protect national wealth while integrating geoeconomic security and weaponized trade strategies. In this new conjuncture, the state seeks to protect not only economic but also strategic interests. The US–China rivalry is a critical arena where this transformation takes center stage. The declining effectiveness of international organizations such as the WTO supports the rise of trade wars and unilateral geoeconomic policy. In this environment, it is inevitable for Turkey and similar countries to redefine economic security and shift elements of defense strategy to the economic domain.

### 3. The Big Break in Supply Chains: COVID-19 Pandemic

Global supply chains are production and distribution networks in which stages such as design, manufacturing, marketing, and distribution are carried out across multiple countries, largely managed by multinational firms in an integrated manner. Firms face various internal and external risks. On the supply side, these include facility fires, natural disasters, financial fluctuations, political instability, cyberattacks, quality problems, and delivery disruptions. Such risks can disrupt production and negatively affect operational continuity and cost structures. On the demand side, factors such as product reputation, new market entrants, policies restricting market access, macroeconomic crises, and exchange rate volatility are key risks that directly affect revenues and marketing strategies (Miroudot, 2020: 117–118).

In this context, supply chain management (SCM) plays a central role in holistically managing these risks. SCM not only coordinates the flow of goods and services but also anticipates vulnerabilities along the chain and provides strategic plans for risk mitigation. An effective approach includes developing alternative sources of supply, establishing flexible logistics structures, increasing traceability via digital technologies, and strengthening stakeholder cooperation. In this way, firms become more resilient to both supply- and demand-side shocks and safeguard operational sustainability.

However, the COVID-19 pandemic that began in 2020 revealed how fragile global value chains—one of the most tangible outcomes of globalization—can be. The crisis, which started in Wuhan, China, soon caused disruptions in production and logistics worldwide (Evenett, 2020). For example, factory shutdowns in Hubei province—an important high-tech hub integrated into global supply chains with concentrations in automotive, electronics, and pharmaceuticals—had ripple effects (Javorcik, 2020: 211). Subsequently, port closures, rising transport costs, and container shortages significantly impeded the movement of raw materials, intermediates, and

final goods. These disruptions caused delays and product shortages in markets (Şahin, 2024: 59). There were acute shortages in strategic products such as masks, medical equipment, vaccines, and later chips, food, and energy (Evenett, 2020). This supply shock disrupted production processes, raised costs, and generated inflationary pressures, leaving deep negative effects on the global economy (UNCTAD, 2021).

This situation triggered the search for “strategic autonomy” in critical sectors and spurred policies to reduce external dependence. The EU announced a vision of “open strategic autonomy” and emphasized self-sufficiency in areas such as health, digital technology, and the green transition (Codagnone, 2021). The US sought to revitalize domestic semiconductor manufacturing through the CHIPS and Science Act (AUSGI, 2022). Japan and South Korea similarly supported reshoring in critical sectors.

In the aftermath of COVID-19, “security of supply” has become a new normative reference point for trade policy. States now aim to create a production–trade architecture based on risk management, not just efficiency (UNCTAD, 2021).

#### **4. Case Studies: Reflections of Protectionism and Blocs**

Rapid economic integration driven by globalization deepened interdependence among countries and created a system in which trade cooperation was reinforced by institutional structures. Regional blocs such as the EU, NAFTA, and APEC played important roles in boosting growth and trade. However, rising geopolitical uncertainties, economic nationalism, and populist policies have led some countries to question these integrations and to take steps toward decoupling from the global trade regime. The UK’s decision to leave the EU is one of the most striking examples. This process, dubbed Brexit, was not only a political rupture but also a new point of departure for debates about how economic cooperation can unravel. In this framework, this section discusses the effects of Brexit on the new trade regime, border issues regarding Northern Ireland, and the redefinition of relations with the EU. It also addresses structural debates on the sustainability of regional integrations, trade diversion, and the future of the global trading system.

##### **4.1. Brexit: A Tale of Divergence and Its Trade Consequences**

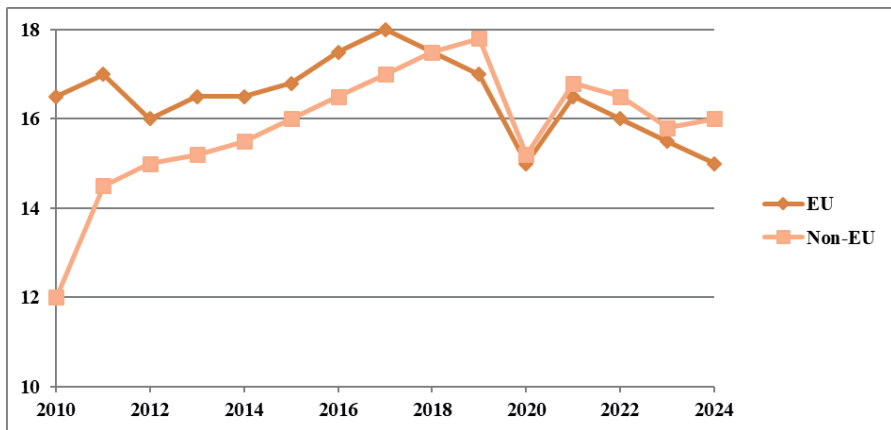
The EU’s Single Market provides significant advantages to member states by enabling businesses to trade at low cost under harmonized rules. The right of free access allows businesses to operate from a single base and

conduct transactions with simpler procedures and lower costs. Common, harmonized regulations across member states lower compliance costs and reduce the complexity of implementation. This common regulatory framework enhances the predictability of legal and administrative rules, reduces uncertainty for firms and consumers operating across borders, and strengthens mutual trust (Kılıcı, 2018: 2).

The UK's departure from the EU was thus not only a political rupture but also a structural transformation of long-standing economic integration. The exit, which officially took place on January 31, 2020, led the UK to reshape its trade policies and redefine its trade regime.

In this new process, the Trade and Cooperation Agreement (TCA), which regulates the future of UK–EU relations, entered into force on January 1, 2021. Under the TCA, UK–EU trade continues without tariffs and quotas; however, because the UK is no longer an EU member, the re-establishment of a customs and regulatory border has increased trade costs (Freeman et al., 2022; Crowley et al., 2022: 47).

*Figure 1. UK Exports (2010-2024)*



*Source: Webb and Ward, 2025.*

Figure 1 shows that the UK's goods exports to the EU failed to show a steady recovery after Brexit. Goods exports, which hovered above £215 billion in 2017–2019, did not reach those levels after the UK's departure. As of 2024, goods exports to the EU amounted to £177 billion, indicating persistent structural change in the UK's foreign trade.

This development prompted the UK to diversify its trade relations and reposition itself globally by concluding independent free trade agreements (FTAs) outside the EU. The Comprehensive Economic Partnership Agreement (CEPA) with Japan, which entered into force in 2021, stands out as the UK's first major bilateral FTA (Gov UK, 2025). Subsequently, agreements with Australia and New Zealand covering agriculture, digital trade, and services entered into force in 2023. The Digital Economy Agreement (DEA) with Singapore includes innovative provisions on data flows, cybersecurity, and e-commerce (UK Gov, 2025). The UK also took strategic steps to strengthen multilateral cooperation. In particular, its accession to the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), completed in 2023, demonstrates the UK's aim to deepen integration in the Asia-Pacific. The CPTPP is not limited to trade in goods; it encompasses more than 30 chapters, including technical barriers to trade, SPS measures, competition, public procurement, services and investment, e-commerce, telecoms and financial services, environment and labor, and intellectual property rights (STM, 2023). It is one of the largest trade agreements concluded after Brexit (Üren, 2024).

Brexit also affected political and economic balances on the island of Ireland. EU membership had facilitated integration between the Republic of Ireland and Northern Ireland. During the Brexit process, both expressed a preference to remain aligned with the EU, bringing independence debates back onto the agenda (Cengiz & Kutlu, 2021: 365). In this context, the Northern Ireland Protocol and associated border arrangements play a critical role for both economic integration and political stability.

The Northern Ireland Protocol is a unique arrangement that has been at the center of post-Brexit crises both large and small. The Protocol aims to avoid a hard border on the island of Ireland by keeping Northern Ireland—unlike the rest of the UK—aligned with certain EU customs and Single Market rules for goods. It is grounded in the Good Friday/Belfast Agreement and was adopted in the Withdrawal Agreement negotiations. Without the Protocol, Brexit would have made border controls inevitable (Araujo, 2022: 532).

In conclusion, Brexit has profoundly affected not only the UK's trade regime but also political and regional balances. Although the post-Brexit trade agreements reflect an effort to reposition globally, fully replacing the regulatory harmonization and low-cost advantages provided by the EU appears challenging.

## 4.2. Regional Blocs: Global Trade Squeezed Between Power Centers

Recent developments have weakened the multilateral trading system and led to the re-emergence of regional trade blocs. In particular, gridlock within the WTO has encouraged countries to pursue regional agreements that are more flexible, faster, and aligned with strategic interests. New-era regional arrangements such as the Regional Comprehensive Economic Partnership (RCEP), the CPTPP, and the African Continental Free Trade Area (AfCFTA) are mega-blocs that go beyond classic FTAs to encompass investment, the digital economy, intellectual property, and competition policy. RCEP, the largest trade bloc, brings together ASEAN countries with China, Japan, South Korea, Australia, and New Zealand, covering around 30% of the world's population and GDP at signing. The CPTPP, with its members, represents around 14.5% of global GDP and includes advanced standards in services, environment, digital trade, and investment. The AfCFTA, with 55 participating countries targeting a market of about 1.3 billion people, aims to promote Africa's economic integration (WEF, 2023).

Traditional blocs are also evolving. The EU has deepened from a customs union to a monetary union and a regulatory polity with increasing political integration. NAFTA's evolution into the USMCA introduced new rules prioritizing US interests in areas such as automotive, digital trade, and intellectual property (Oustr, 2025).

Mega-regional agreements such as RCEP and CPTPP are not only technical arrangements for liberalization; they are also strategic moves in a geo-economic arena marked by US–China competition. RCEP is seen as institutionalizing China's economic leadership in the Asia-Pacific (Hopewell, 2021), and the absence of the US allows an alternative trade order to emerge centered on China. In contrast, CPTPP was carried forward by US allies such as Japan and Australia after President Trump withdrew from the TPP in 2017 (Katada, 2021). Both blocs project power based not only on economic ties but also on regional dependency relationships. They reflect both a reconfiguration of global trade governance and efforts by major powers to rebuild geoeconomic spheres of influence.

While these integrations facilitate trade and reduce costs via regulatory harmonization among members, they can also pave the way for a new generation of protectionism through their exclusionary features. In particular, rules of origin, technical regulations, digital service standards, and harmonized non-tariff measures can become indirect but effective barriers for non-members. This challenges the WTO's most-favored-nation

(MFN) principle and undermines the coherence of global trade (Baldwin, 2006). The resulting “spaghetti bowl” of rules makes the trading system less transparent, predictable, and manageable (Bhagwati, 1995).

### 5. The Economics of a Tariff-Driven World: Winners and Losers

Tariffs are frequently used to pursue economic and political objectives. Whether to protect domestic production or reduce trade deficits, tariffs have heterogeneous effects across the global economy. Typically, they increase domestic prices, reduce real incomes, generate productivity losses, and may appreciate the domestic currency. These developments tend to neutralize the intended positive impact on the trade balance. The most unfavorable scenario is the emergence of a global trade war triggered by the spread of tariffs, trade restrictions, and retaliation among major economies (Dupuis & Genereux, 2017: 1).

To observe tariffs’ repercussions concretely, US tariffs targeting different sectors can be analyzed. Historically, the US has launched several episodes of tariff escalation, significantly increasing import costs. The Smoot–Hawley Tariff Act of 1930 raised duties on about 900 products by an average of 40–48%. Similar steps in subsequent periods contributed to contractions in world trade. A recent example is the tariffs imposed during Trump’s first term: 25% on more than 800 products imported from China, and 25% and 10% on steel and aluminum from the EU, Canada, and Mexico, respectively (Şanlı & Ateş, 2020: 85).

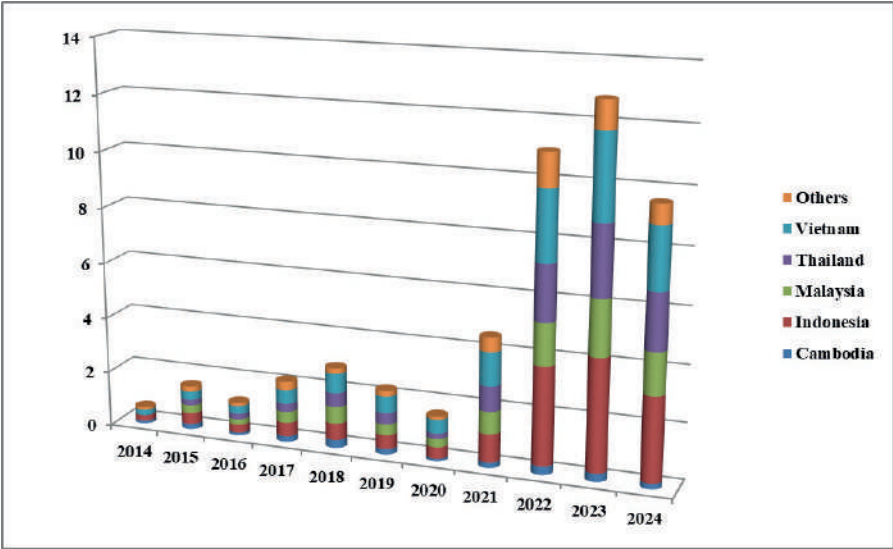
More recently, the “Liberation Day” tariffs announced by the US have created serious uncertainties for the global economy and geopolitical balances. Under the slogan “Make America Great Again” (MAGA), this approach reflects a strategy of exerting pressure through trade policy, citing concerns about foreign debt, competitiveness, job losses, and the dollar’s reserve status. These actions are not limited to tariffs; they sometimes include threats of additional sanctions on BRICS countries if they abandon the dollar in mutual trade, and attempts to compel other countries to supply critical minerals and raw materials needed by US industry. Political, diplomatic, and social issues can also be subjected to trade sanctions on national security grounds (Akman, 2025). Following tariffs imposed on steel, aluminum, and automobiles imported from Canada, Mexico, and China in February–March 2025, comprehensive “reciprocal” tariffs covering most trading partners were announced. These new tariffs—based on the ratio of the US bilateral trade deficit to imports rather than existing tariff differentials—exceeded market expectations (Conteduca et al., 2025).

Countries most affected by these policy changes include Canada and Mexico, whose economies are highly dependent on the US, and China, the main counterpart in the ongoing trade conflict. The US is pursuing a multi-pronged strategy of economic pressure on China—not only through tariffs, but also by encouraging US companies to reshore production and by imposing security-based restrictions on Chinese-origin FDI (Akman, 2025: 7–8).

These developments have highlighted the need for countries and companies to reduce overdependence on China, bringing the “China Plus One” strategy to the fore. The strategy seeks to diversify supply chains by expanding production or sourcing to countries other than China while maintaining a presence there, in order to mitigate risks amid rising geopolitical tensions. Beneficiaries include India, Vietnam, and Malaysia, particularly in semiconductors. India and Vietnam are positioning within the global semiconductor supply chain, while Malaysia is building on its well-established industry with over 50 years of manufacturing experience (Tan, 2025: 5).

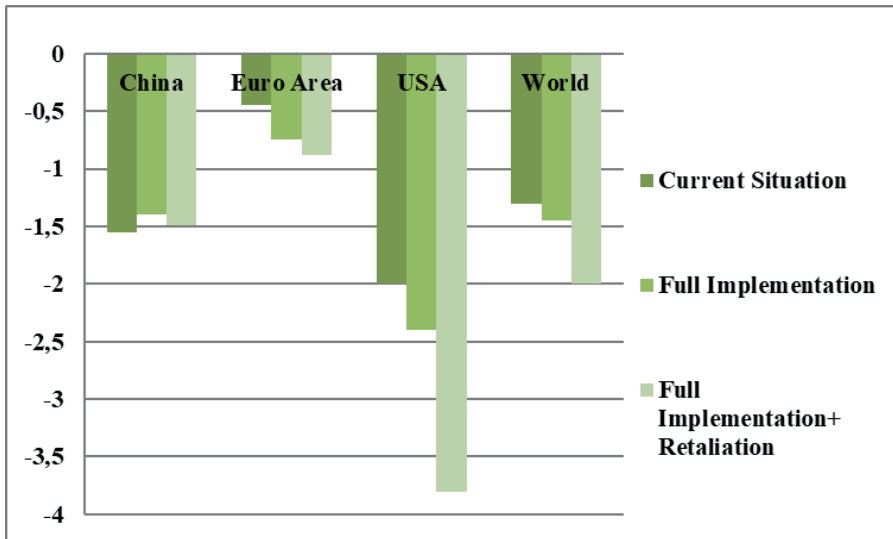
Rising labor costs in China are another reason why many Chinese and multinational manufacturers are relocating to these countries. According to the Rhodium Group, investments—especially in textiles, household goods, and consumer electronics—rose from an annual average of USD 240 million to USD 560 million during 2018–2021, with Vietnam at the center of this shift. The same report notes that a significant portion of China’s FDI in Southeast Asia is concentrated in four countries.

Figure 2. Chinese FDI to ASEAN Countries between 2014-2024 (Billion Dollars)



Source: Meyer and Kratz 2025.

The figure shows the distribution of Chinese FDI to ASEAN countries during 2018–2024. Around 56% of these investments went to Indonesia and Vietnam, with Thailand and Malaysia accounting for 18% and 14%, respectively. Indonesia, in particular, has gained momentum and has become a dominant recipient, attracting nearly 30% of total Chinese FDI to the region over the last three years. The main drivers include investment facilitation and infrastructure capacity in capital-intensive sectors such as electric vehicles (EVs). However, these data do not fully reflect the regional attractiveness of Thailand, Vietnam, and Malaysia. These countries remain important hubs for smaller-scale, diversified investments. In fact, these three accounted for 77% of Chinese investment flows in the last three years, suggesting that production is being reshaped not only by large capital projects but also by SMEs (Meyer & Kratz, 2025).

*Figure 3. Projected Change in Welfare (%)*

Source: Conteduca et al., 2025.

Figure 3 shows the estimated welfare impacts of the US tariffs in percentage changes. Conteduca et al. (2025) consider three cases (current situation, full implementation, and full implementation+retaliation) and show that tariffs affect not only target countries but also the imposing country. Despite potential short-term gains for domestic producers, aggregate welfare may decline significantly. In particular, consumer welfare falls due to higher import costs and reduced variety. Disruptions to global supply chains and retaliatory measures further contribute to welfare losses. Thus, protectionist policies can negatively affect not only trade volumes but also long-term economic welfare.

## Conclusion

At the beginning of the 21st century, world trade—invigorated by globalization—has, in recent years, become as much a strategic and political instrument as an economic one. As confidence in the global free trade system has been shaken, countries are increasingly turning to protectionist policies, shaping international trade through tariffs, sanctions, and regulations in line with national interests. This transformation profoundly affects not only economic structures but also the nature of international relations. Combined with social issues such as rising inequality, unemployment, and migration, the new wave of protectionism has become part of a search for political

legitimacy as well as an economic choice. Today's trade policies have thus evolved away from multilateral free trade toward a more competitive, selective, and strategic structure.

This new era reflects a period in which globalization is contested, nation-states reassert themselves, and economic instruments serve political purposes. Trade is being repositioned not only as an exchange relationship but also as a multidimensional indicator of power with norm-setting, guiding, constraining, and punitive functions. The strategic nature of trade points to a structural transformation that requires rethinking both economic theory and international relations. In the coming period, the effects of these trends on the global economic order will likely become more evident, and international trade will continue to be a determinant not only of economic growth but also of the global balance of power.

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## The Economic Policy of The Us-China Trade War 3

Özgür Kanbir<sup>1</sup>

### Abstract

This chapter analyzes the political economy of the US-China trade war, arguing that it is a symptom of a deeper structural imbalance within the US economy rather than a conflict simply caused by China's rise. The central thesis is that the United States suffers from a chronic "low-savings/low-net-investment" paradox, a weakness that has persisted for decades. This structural issue has been masked and enabled by the "exorbitant privilege" of the US dollar's status as the global reserve currency, which allows the US to finance high consumption through persistent trade deficits. The chapter demonstrates that the massive trade deficit with China is a consequence of this dynamic—with China acting as "the world's factory" to meet US demand and recycling its dollar surplus back into the US financial system—not its root cause.

Through an analysis of long-term trade, savings, and investment data, the chapter shows that protectionist tariffs are a flawed policy. They fail to address the underlying savings-investment gap and instead impose costs directly on American consumers and producers via price increases. Furthermore, the chapter highlights the phenomenon of "trade diversion," where the deficit has not been eliminated but has merely shifted to other partners like Mexico and the European Union, proving the ineffectiveness of the tariffs. Ultimately, the chapter concludes that the trade war represents a painful acknowledgment that the dollar-centric global system has become unsustainable for the US itself, transforming the old adage "the dollar is our currency, but your problem" into a new reality where the dollar is now America's problem as well.

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## 1. Introduction

In the global economic arena of the 21st century, perhaps no competition has been as decisive as the tension between the United States and China. Headlines adorned with tariffs, mutual accusations, and this conflict dubbed the “trade war” are often presented in populist language as a simple story of lost jobs and massive trade deficits. So, if the issue is so straightforward, why is the world’s most sophisticated economy taking steps that undermine the rules of the free trade system it established and has led for decades? Is this war truly a belated response to China’s unstoppable rise, or is there a much deeper, structural crisis lurking behind the scenes, one rooted in the United States’ own internal dynamics?

This section looks beyond the visible face of the conflict and examines the political economy of a deeper, structural transformation whose roots stretch back decades. Our fundamental argument is that the US-China trade war is a symptom rather than the disease itself. The underlying disease is a chronic problem of “low savings-low investment” in the US economy, which has persisted for half a century and has been masked by the “exorbitant privilege” conferred by the dollar’s status as the global reserve currency. This privilege, which once provided the US with unlimited financing and consumption power, has gradually engendered policy complacency; it has become a “sweet poison” that erodes the country’s real capital accumulation and long-term growth potential.

In this context, the massive trade deficits with China are not so much a cause of this structural imbalance as an inevitable consequence. While the US sustained its consumption-led growth model by borrowing in its own currency, China became the world’s manufacturing hub to meet this demand and reinvested the resulting dollar surplus back into the US financial system, feeding the cycle. Therefore, the protectionist policies that began with the Trump administration and continue today are, in fact, doomed to failure. Rather than addressing the root cause of the disease, they target only the most visible symptom, the external deficit, but shift the cost back onto its own consumers and producers.

In this section, we will first examine the evolution of the post-World War II global economic order and the shifting power balances brought about by China’s integration into this system from a historical perspective. We will then analyze foreign trade, global export shares, and external deficit data to question the empirical foundations of the arguments presented as the fundamental rationale for protectionist policies. The focus of the chapter will be to reveal how the US finances its external deficits and the key role of

the dollar's reserve currency status in this equation. Finally, by thoroughly examining the US economy's fundamental structural weaknesses in savings and investment tendencies, we will demonstrate with concrete data why trade wars are the wrong solution and the welfare loss they create.

This analysis aims to demonstrate, beyond populist narrative and short-term political maneuvers, that the US-China trade war is actually a painful reflection of a system created by the dollar's global hegemony that has become unsustainable, based on data and theoretical frameworks. For, as former Treasury Secretary John Connally once told his European counterparts, "The dollar is our currency, but your problem," has now become "The dollar is our currency and now our problem too."

## 2. Developments In the Global Economy After World War II

A new global economic system was established after World War II. European countries, which had been at war, acted under a vision of peace and developing economic relations, led by the United States. Over the next few decades, the trade volume and economic growth process created by this system generated great prosperity in the Western world. In particular, the Bretton Woods Conference in July 1944 led to the establishment of the International Monetary Fund (IMF) and the World Bank (WB), and the General Agreement on Tariffs and Trade (1947-GATT), which would become the World Trade Organization (WTO) in 1995, institutionalizing the capitalist world economy. The framework provided by these institutional structures has accelerated global trade volume and global economic growth. This development has been shaped primarily around the phenomenon of globalization. Parallel to these developments, the European Coal and Steel Community (ECSC) evolved into the European Community (EC) and subsequently the European Union (EU), resulting in the world's most successful regional integration.

With the end of World War II, the world transitioned to a bipolar order consisting of the Western Bloc (capitalist system) led by the United States and the Eastern Bloc (socialist system) led by the Soviet Union. The US sought to impose its new liberal ideas and free market economy on the world, becoming a hegemonic power that enabled European countries devastated by the war to return to a free market economy. In this vein, the Bretton Woods agreements of 1944 established a new monetary system based on a fixed exchange rate tied to the US dollar, and the Marshall Plan facilitated the re-entry of European states into the world market. The controlled nature of financial markets in the capitalist world increased the effectiveness of

national economic policies, ensured stable exchange rates and interest rates, and allowed inflation to remain at low levels. Direct investment and aid to developing countries played a role in their development and provided raw materials and labor to developed countries. However, it should be noted that the main economic policies of this period were based on *Keynesian economic* policies. Before 1980, Western economies were largely characterized by government-directed economic policies and widespread planning.

The oil crisis that began in the early 1970s, along with the emergence of stagflation in the Western world, paved the way for new approaches. Keynesian policies and welfare state practices began to be questioned. During this period, US President Nixon's decision to allow the dollar to float and OPEC's decision to raise oil prices were influential.

Starting in the 1980s, free market and liberalization policies found room for implementation. During this period, Keynesian policies began to be abandoned and supply-side economic policies were put into practice. *The debt crisis* in developing countries and the subsequent process of financial liberalization were events that influenced the internationalization process of this period. *Monetarist policies* began to be implemented during this period. Tight monetary policies, high interest rates, reduced government intervention, and privatizations became widespread. Developments in communication and information technology made financial liberalization inevitable and increased competition among countries to attract financial institutions. It has been observed that financial markets are among the fastest globalizing areas, with capital being instantly transferred from country to country through electronic intermediaries. However, this situation has played a destabilizing role in the world economy due to hot money flows chasing speculative gains (Eşkinat, 2016a, p. 74).

Newly industrialized countries such as the Asian Tigers (Japan, South Korea, Hong Kong, Taiwan, Singapore, Malaysia, Thailand, and Indonesia) have achieved great economic success by pursuing common policies such as export-led growth, high savings rates, state-led industrialization, and market targets (Eşkinat, 2016a, p. 68). China became the world's fastest-growing economy by implementing capitalism-based economic reforms in 1978 and introduced a new system called the "socialist market economy" (Eğilmez, 2020, p. 90). With the collapse of the Soviet Union in the early 1990s, the bipolar world order came to an end, leaving the US as the sole superpower. However, this situation also brought political and economic instability. Globalization gained momentum, and regional economic unions (EU, NAFTA, APEC) gained importance. The 1990s witnessed crises stemming

from debt problems, such as the Asian crisis, the Russian crisis, and the crises in Argentina, Brazil, and Mexico. The IMF intervened in these crises, attempting to stabilize global capitalism.

The 2008 Global Economic Crisis, which began in the US real estate sector and spread to the global financial system, has been the most serious problem faced by the capitalist system since 1929. The crisis resulted from the financial sector taking excessive risks and the bursting of the real estate price bubble. Following the crisis, economists' existing theories were questioned, and alternative approaches such as New Keynesian policies came to the fore (Eğilmez 2020: 154).

The global balance of power continued to shift from the West to the East. China's share of global GDP has increased, while that of the US and Europe has decreased. A group of countries known as *Emerging Markets* (BRIC countries, Mexico, Indonesia, Turkey, etc.) have rapidly approached the economic level of developed countries (Eğilmez, 2020, p. 188).

Today, the global economy is moving towards a structure dominated by Industry 4.0 in production and digital information in consumption. Environmental issues and sustainable development concepts have become important topics for the future of the global economy. Concerns have arisen about whether total global resources will be sufficient for future generations and the pressure of the growing population on resources.

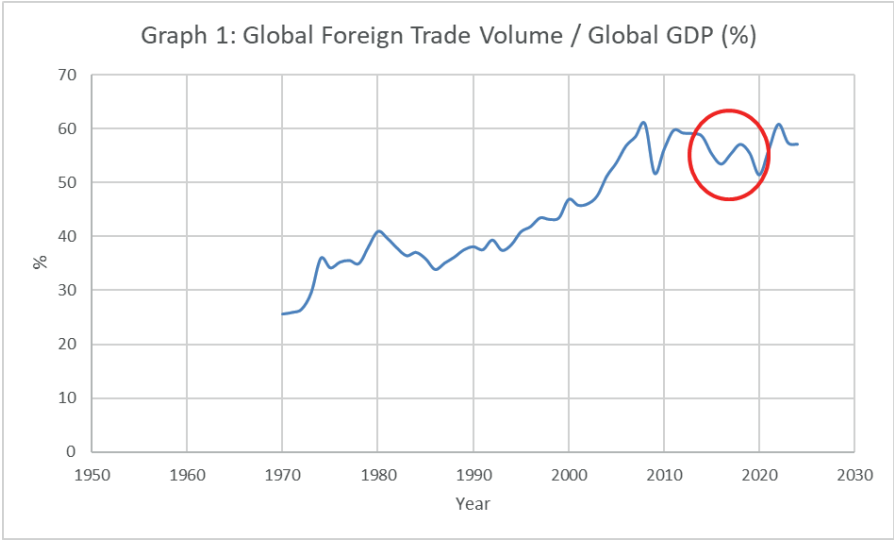
After World War II, international political economy transformed into a bipolar system. After 1991, it evolved into a unipolar system based on US hegemony. However, since the 2000s, we have seen a weakening of US hegemonic power. The emergence of China and Russia as global economic powers is transforming the international political economic structure. The new international economic structure has become quite complex. This structure includes technological advances, financial liberalization, the reduction of poverty, increasing international integration, global crises, regional wars, income inequalities, and environmental problems.

When we evaluate this period in terms of global economic growth and the upward trend in global trade volume, a more detailed picture emerges. An important development emerged in the 1970s, with international trade continuing to grow faster than national production. This trend continued with general stability until the 2008 crisis. After 2008, new developments affecting global economic development and prosperity emerged. The global economic crisis, the increase in geopolitical and geoeconomic risks, the intensification of regional wars, the protectionist policies that began during

Trump’s first term, and the 2020 Covid-19 pandemic have shown that this new era is a challenging period in terms of the course of globalization.

**2.1. Developments in Global Trade and Global Production**

World trade grew at an average annual rate of 6.6 percent between 1948 and 1966 and 9.2 percent between 1966 and 1973. During this period, the UK’s share of world trade declined, while the EU and Japan’s trade activity increased. The share of industrializing countries in world trade rose to between 25 percent and 30 percent in the 1950s (Eşkinat, 2016b, p. 170).

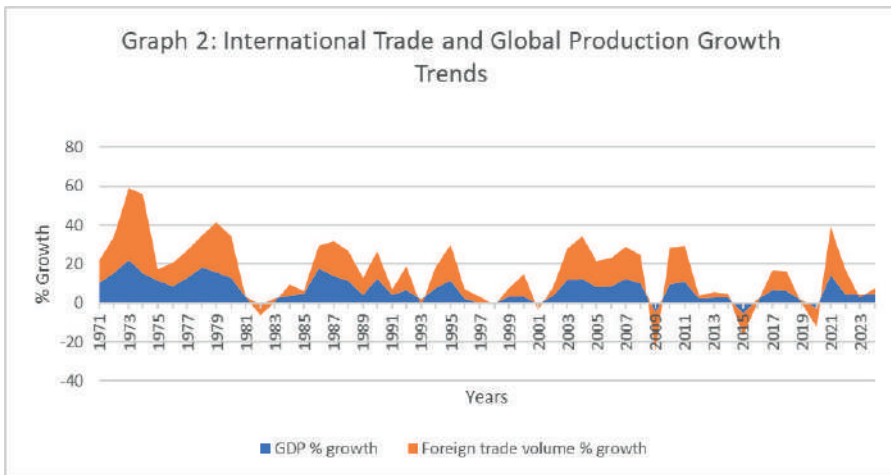


*Source: Prepared by the author using data from The World Bank, world development indicator .*

Graph 1 shows the ratio of global foreign trade volume (imports + exports) to Gross Domestic Product (GDP). The most important feature of this graph is that it clearly shows the course of the globalization process. The fact that foreign trade’s share in world production has increased to this level shows us the extent of integration achieved through globalization. Until the 1970s, the volume of foreign trade was around 20 percent of global GDP, but after this period, it increased rapidly, reaching 60 percent in 2008. This development took place in an environment supported by both wars and institutional developments in the global system. The 1990s marked the beginning of a new era, accelerating the momentum in global trade volume. The collapse of the socialist system and the integration of transition

countries into the global system led to a significant increase in global trade volume. After the 2008 global economic crisis, global foreign trade volume remained in the 50-60 percent range. This trend over the last fifteen years indicates that a new era of globalization has begun. Globalization appears to have reached a certain saturation point. This secular shift has been dubbed ‘slowbalization’.<sup>2</sup> The impact of the protectionist policies implemented during Trump’s first term, as seen in the period marked by the highlighted period (2009–2013), led to a decline in global trade volume. Between 2017 and 2020, there was a significant decline of approximately 7-8 points in the share of global trade in the world economy. This means that the global economy has become more “insular” and international trade has slowed down.

Supply chain disruptions during the COVID-19 pandemic, layered on top of these policies, further increased the fragility of the global trading system.



*Source: Prepared by the author using data from The World Bank, world development indicator .*

Graph 2 compares global GDP growth rates with the growth rate of international trade volume. Outside of global economic crises, during normal economic periods, the growth of international trade volume has always exceeded global production growth.

<sup>2</sup> The new era in which globalization has slowed but not stopped.

Trade volume growth is both faster and more volatile than GDP growth in the long term. It declines more sharply during contractions and rises more rapidly during expansions. This is consistent with theoretical analyses (Eaton et al., 2016). Until 2008, the elasticity of international trade to GDP generally remained above 1. However, it declined structurally after 2008, marking the beginning of the slowbalization era (Constantinescu et al., 2015; World Trade Organization, 2023). The sharp decline observed during the 2009 global crisis and the 2020 pandemic, followed by rapid recovery patterns, confirms trade's extreme sensitivity to the cycle (Baldwin, 2009; Eaton et al., 2016; World Trade Organization, 2022).

A significant portion of the items that make up trade are investment and durable consumer goods; the income elasticity of these items is greater than 1. Small changes in the cycle translate into large fluctuations in trade (Bussière et al., 2013). Therefore, the graph shows that trade has sharper peaks and troughs compared to GDP (IMF, 2016).

Increased vertical specialization in the 1990s and 2000s led to the same final product crossing multiple borders. The increase in added value resulting from small changes in production, combined with international trade, led to growth (Baldwin, 2016; Hummels et al., 2001). The slowdown in the deepening of *global value chains* (GVCs) after 2008 explains the decline in elasticity observed in the graph (Constantinescu et al., 2015). *Containerization*, information technology, and multilateral/bilateral agreements reduced effective trade costs in the late 1980s and 2000s. Conversely, increasing variety and economies of scale have made trade grow faster than GDP (Hummels, 2007; Krugman, 1979). Rising protectionism and geopolitical uncertainties in the 2010s have weakened this effect (IMF, 2016; World Trade Organization, 2023).

During crises, trade finance tightens and dollar tightening suppresses external demand; this channel is evident in the sharp decline seen in 2008–09 (Amiti & Weinstein, 2011; Chor & Manova, 2012). The sharp decline in 2009 and the recovery in 2010, as seen in Graph 2, are also consistent with this mechanism.

Demand shocks are amplified and passed up the supply chain. The collapse due to stock depletion before the pandemic, followed by a surge in 2021 due to stock replenishment and pent-up demand, is a typical example of this effect (Lee et al., 1997; World Trade Organization, 2023).

Open economy models predict that real exchange rate movements affect trade volume; however, the large fluctuations in the graph are explained

not by the exchange rate alone, but by the structural and financial factors mentioned above (Dornbusch, 1976; IMF, 2016). In the mid-1990s and early 2000s, trade growth significantly exceeded GDP growth thanks to the expansion of GVC and low trade costs (Baldwin, 2016; Hummels, 2007; Hummels et al., 2001). In the 2009 period, however, the Great Trade Collapse occurred, and international trade via credit, logistics, and GVC channels contracted much more sharply than production. The slowdown in trade volume during the 2012–2019 period, which occurred at a rate close to GDP, stemmed from a permanent decline in elasticity (Constantinescu et al., 2015; IMF, 2016). In the 2020–2021 period, the Covid-19 pandemic collapse and base effect led to a rapid rebound supported by inventory replenishment.

In the medium term, the growth of goods trade does not appear likely to be significantly higher than GDP. Considering the new protectionist tendencies initiated by Trump in his second term, this effect may be observed in the short and medium term. Unless the share of trade in services (especially digital services) increases, the “trade turbo effect” similar to that seen in the 2000s will remain limited (Baldwin, 2016; IMF, 2016; World Trade Organization, 2023).

### 3. Are There Economic Reasons for The U.S. Turning to Protectionism?

During his first term, Trump imposed tariffs on Chinese iron and steel products on March 8, 2018, to protect domestic producers and industries. New tariffs (International Emergency Economic Powers Act-IEEPA) were announced on April 2, 2025, declared “*Independence Day*.” Following the ensuing shock and stock market decline, the tariff implementation was suspended. However, new tariffs came into effect on August 7, 2025. The newly implemented tariffs raised the US average effective tariff rate above 17 percent (Yale University, 2025). This rate is the highest seen since 1935.

The tariffs have a two-tiered structure. A base tariff of 10 percent was applied to countries with no trade deficit and not subject to sanctions. On top of this, rates ranging from 11 percent to 50 percent were applied to countries with a trade deficit. Additional customs duties have been imposed, particularly on China (34 percent), Canada (35 percent), Mexico (30 percent), and EU countries (15 percent). Trump justified this measure by citing the need to increase domestic production, create jobs for Americans, and pay off the national debt. The reason for selecting specific countries other than China, particularly Canada, Mexico, and the EU, is the phenomenon of *trade diversion*, which we explain below.

At first glance, these measures are reminiscent of the negative consequences of the Smoot-Hawley tariffs of 1930 for the US. The Hawley-Smoot Tariff Act of 1930 exacerbated the effects of the Great Depression and plunged global trade into unprecedented difficulties.

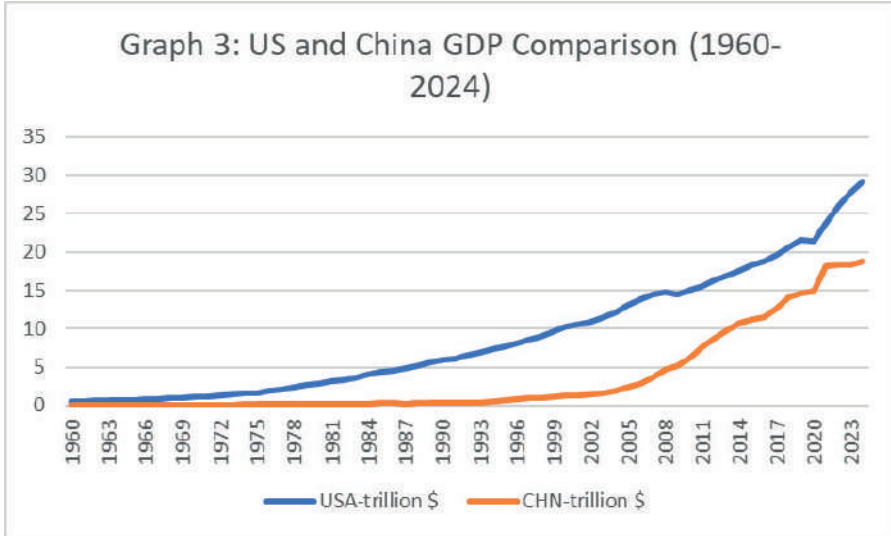
However, US foreign trade policy underwent a transformation, particularly after World War II, shifting towards reciprocity and the establishment of GATT. In the second half of the 20th century, especially in the 1980s, Japan became the primary target as the trade deficit rose rapidly and protectionism resurfaced. After the Cold War (1989), US trade policy focused on promoting free trade and globalization, and the WTO was established in 1995.

Under the Trump administration, however, fundamental changes have taken place under the *America First* principle, such as withdrawing from the Trans-Pacific Partnership and launching a trade war against China. Past conflicts (for example, with Japan over automobiles and semiconductors) have generally resulted in concessions from Japan, such as voluntary export restrictions to smooth over the issues. In some cases, such as the 2002 Steel War, the US withdrew tariffs in response to the European Union's threat of retaliation. However, the current China-US Trade War appears unique in terms of its scope and content. The new war is taking place in the context of globalization, strong Foreign Direct Investment (FDI) flows, and technological competition, unlike traditional trade conflicts (Guoyong and Ding 2021).

Economic relations between the United States (US) and China can be described as an "economic nationalism and competition-focused trade war," which began under the Donald Trump administration and continues under the Joe Biden administration. This period represents a break from the Open Door Globalism strategy the US had pursued for decades, in response to China's rise and the contradictions brought about by globalization.

Traditionally, the US grand strategy was based on an open door policy aimed at economic and extraterritorial expansion. This policy promoted a liberal world order that supported American hegemony and enabled the opening of global markets. However, under the Trump administration, this globalization-focused approach transformed into economic nationalism, a reaction against globalization fraught with internal and external contradictions. This transformation began very rapidly, particularly during Trump's second term, as of 2025.

Between 2000 and 2024, the Chinese economy grew approximately fifteenfold, reaching \$18.7 trillion from \$1.2 trillion, becoming the world's second-largest economy and rising to a position of global leadership in manufacturing, technology, and science (The World Bank, 2025).



*Source: Created by the author using World Bank data.*

Assuming the current trend continues until 2024, Under a naïve linear trend extrapolation (not a forecast), we estimate when China will catch up with the US GDP. Based on the GDP values compiled from the World Bank dataset, the equations obtained from linear regression analysis are as follows:

$$\text{China GDP Trend: } \text{GDP\_CHN}(\text{Year}) = (3.116 \times 10^{11}) * \text{Year} - (6.162 \times 10^{14})$$

$$\text{US GDP Trend: } \text{GDP\_USA}(\text{Year}) = (4.018 \times 10^{11}) * \text{Year} - (7.925 \times 10^{14})$$

By equating these two equations and finding the intersection year, we estimate that by the end of 2032, China's GDP will catch up with the US. The GDP value at the intersection year will be approximately \$34.6 trillion.

Populist narrative and the “America First” Approach: Trump's policies were supported by populist narrative reflecting mottos such as Make America First Again, similar to those of figures such as Buchanan, who ran for president in 1996 (Buchanan, 1990). This rhetoric centered on the idea that global elites had “betrayed” American workers and industry and that international trade had hollowed out the “middle class America.” The

decline of American industry (deindustrialization) and the problems created by foreign competition formed the basis of this populist narrative.

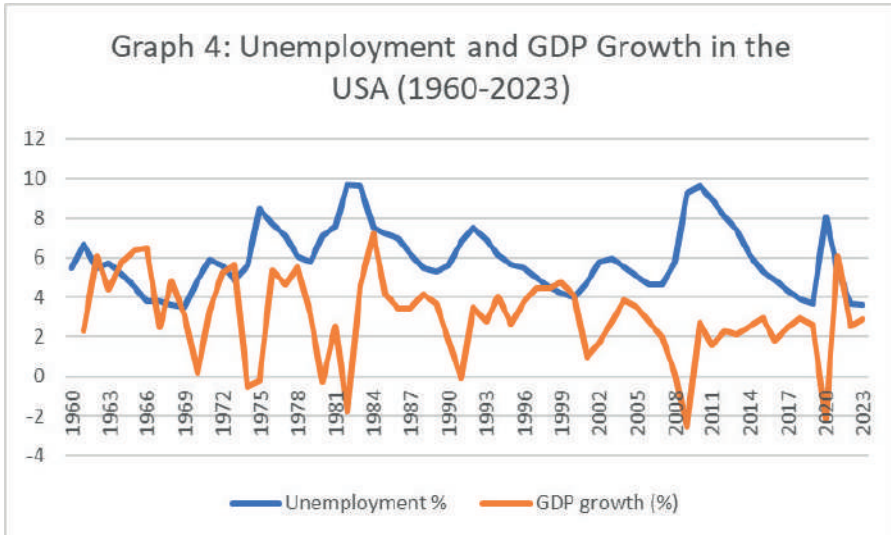
This tension manifested itself in concrete steps such as increasing tariffs and moving production chains away from China (“reshoring” and “decoupling”). The goal was to revive US economic growth and force other countries to comply with US-preferred policies.

The U.S. trade deficit with China has been highlighted as a major source of this tension. The U.S. has viewed China’s industrial policies, such as “Made in China 2025,” and its state-supported development model as a threat to American industry and competitiveness. Concerns that China is exploiting the advantages it has gained through globalization have been effectively articulated in the US for the past twenty years. The criticisms expressed in these publications are as follows :

- China is creating negative effects on American production and employment.
- By pegging its currency, the yuan (renminbi), to the dollar at a fixed rate and keeping its value low (manipulating it), China provides a profitable subsidy to Chinese exporters while imposing a heavy tax on U.S. exports. This is the fundamental cause of the chronic U.S. trade deficit and the slowdown in economic growth.
- China’s “Communist-style state capitalism” completely disregards the principles of free trade. It is dismantling US industries one by one, based on labor. This has resulted in the loss of millions of US manufacturing jobs.
- China is seizing critical global resources (energy, minerals) using “checkbook diplomacy” (low-interest loans in exchange for infrastructure), primarily in Africa and Latin America.
- China generally does business with corrupt regimes without imposing moral conditions such as human rights or transparency.

While some of the criticisms here are valid, it is necessary to approach the criticisms regarding production and employment with caution. First, the average unemployment rate in the US over the last sixty-four years is 5.9 percent. Again, for the same period, the average growth rate is 3 percent. These rates are 5.8 percent and 2.1 percent respectively since China joined the World Trade Organization in 2001. All other things being equal, there is no evidence to suggest that international trade with China has had a negative

impact on unemployment figures in the US. However, the downward trend in long-term growth rates is noteworthy.



*Source: Created by the author using World Bank data.*

As shown in Graph 4, periods of rising unemployment in the US coincide with periods of economic crisis. Outside of these periods, the unemployment rate fluctuates at levels very close to the natural rate of unemployment (4-4.5 percent).

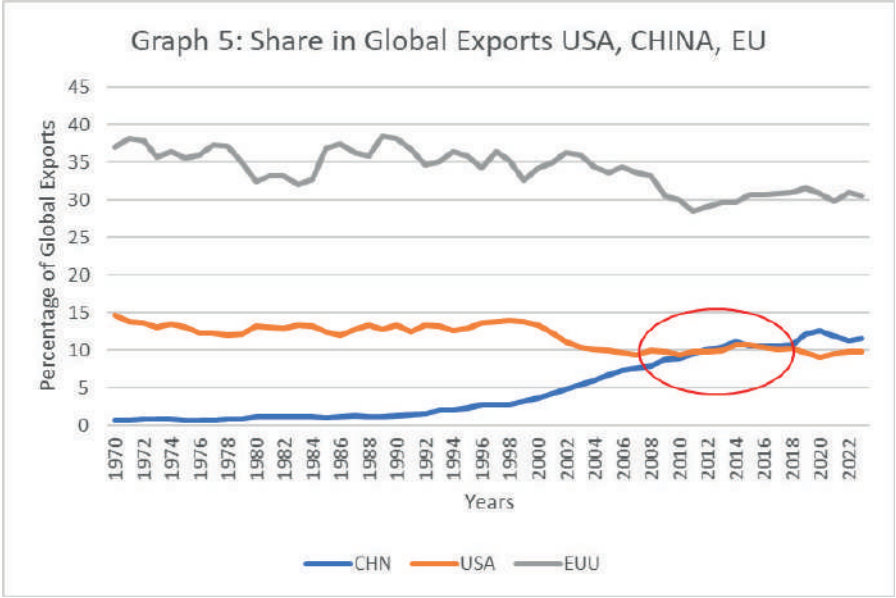
Therefore, in light of long-term unemployment data, we can say that protectionist policies have no justification in terms of unemployment and creating new employment opportunities.

To understand the economic rationale behind the protectionist measures initiated during Trump's first and second terms, analyzing the long-term international trade indicators of the US economy can provide insight.

### 3.1. Global Trade and External Deficits

Looking at the long-term performance of the most important actors in global exports provides an important data set for understanding developments in the current period. Graph 3 shows the share of the United States (US), China, and the European Union (EU), the three key actors in the world economy, in global goods exports between 1970 and 2022. This half-century period is a segment in which the tectonic shifts in global

economic power balances can be most clearly observed. The graph strikingly reveals the extraordinary rise of China as a manufacturing and export giant, in contrast to the relative decline of the US, the leader of the post-World War II Bretton Woods system, and industrialized Europe.



*Source: The World Bank, 2025 Created by the author using data from .*

The change in the export shares of the three main actors in the graph can be interpreted as a reflection of different economic models and different stages of globalization.

Graph 5 shows that the EU, which had a share of approximately 35-40 percent of global exports in the 1970s, struggled to maintain this share throughout the period. The downward trend, which became particularly apparent in the early 2000s, can be explained by several key factors. First, the maturing of EU economies and their shift towards deindustrialization, placing greater emphasis on the service sector. Second, internal shocks such as the 2008 Global Financial Crisis and the subsequent Eurozone Debt Crisis negatively impacted economic growth within the bloc and, consequently, export performance (Eichengreen, 2010). Third, and most importantly, new players such as China, with their low-cost and high-volume production, have aggressively entered global markets. Despite this, the EU has maintained its position as the world's largest integrated market and its strength in high

value-added products, thereby sustaining its leading position in global exports for a long time.

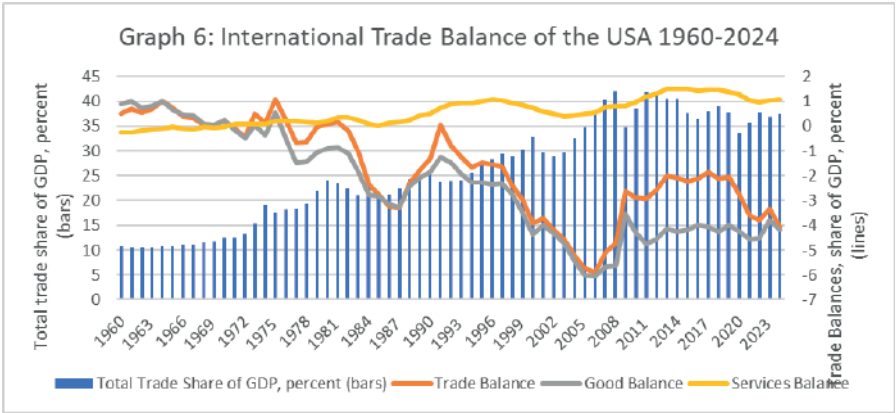
The US share of exports remained relatively stable at around 10-15 percent from the 1970s to the early 2000s. During this period, the US maintained its leadership in technology, finance, and high value-added industrial products. However, since the early 2000s, there has been a noticeable decline in the US share. The fundamental dynamic behind this decline is the process known as “The Great Convergence” (Baldwin, 2016), a new phase of globalization that enables information technologies to fragment supply chains. American multinational corporations have reduced their costs by moving labor-intensive stages of their production processes to countries such as China, which has led to a decline in the share of US goods exports. The 2008 Global Financial Crisis accelerated this decline by dealing a blow to the US economy (Tooze, 2018).

The most striking story in Graph 5 undoubtedly belongs to China. With a share of global exports close to zero in the 1970s, China began a slow rise in the 1980s with its economic reforms and opening-up policies. The real turning point, however, came with China’s accession to the World Trade Organization (WTO) in 2001. This membership ensured China’s full integration into global markets and elevated it to the position of “the world’s factory.” The sharp rise in the graph after 2001 is clear evidence of this. The state-led capitalism model, massive infrastructure investments, low labor costs, and export-oriented industrialization strategy have pushed China’s export share to record levels (Naughton, 2018).

The period marked by the red circle in the graph, 2009-2013, is a symbolic turning point in global economic history. During this period, China’s share of global exports caught up with and then surpassed that of the United States. It is no coincidence that this crossover occurred immediately after the 2008 Global Financial Crisis. While the crisis deeply shook developed economies such as the US and the EU, the Chinese economy recovered rapidly and continued to grow thanks to the massive stimulus package implemented by the Chinese government. This event is considered one of the most concrete indicators of the shift in global economic power from the West to the East. China’s rise has not been limited to low-tech products; over time, it has expanded into high-tech fields such as telecommunications (e.g., Huawei), renewable energy, and electric vehicles, becoming a serious competitor for the US and the EU (Naughton, 2018).

The structure of global trade has fundamentally changed over the past 50 years. The world export market, initially dominated by the EU and the US,

has been reshaped by China’s unprecedented rise. This process highlights the dynamics of globalization, the transformation in the international division of labor, and the success or failure of national economic strategies. The EU’s relative loss of share, the decline of US manufacturing, and China’s seemingly unstoppable rise constitute the macroeconomic reality underpinning today’s trade wars, technological competition, and efforts to restructure supply chains. This picture clearly shows that the global economic order of the 21st century will be determined by the complex competition and cooperation relationships between these three actors. Indeed, the 2008 crisis changed the world (Tooze, 2018), and information technologies have taken globalization to a new phase (Baldwin, 2016).



*Source: The World Bank, 2025 data obtained and compiled by the author.*

Total trade volume, which was approximately 10 percent of GDP in the 1960s, reached 30 percent in the 2000s and has recently approached 40 percent. This trend demonstrates how policies aimed at reducing trade barriers (such as GATT and later the WTO) and technology (container shipping, communications, etc.) have increased global trade since the post-World War II period. The US economy has become much more integrated with the world economy over time.

The US has consistently run a surplus in services trade since the 1970s. This surplus has hovered around 1-1.5 percent of GDP. This reflects the US’s global competitive strength in high value-added service sectors such as finance, technology, education, healthcare, and intellectual property. However, the goods balance shows the opposite trend. Goods trade, which was in balance until the mid-1970s, has been running a continuous and

growing deficit since then. This deficit is the main determinant of the overall trade deficit (orange line).

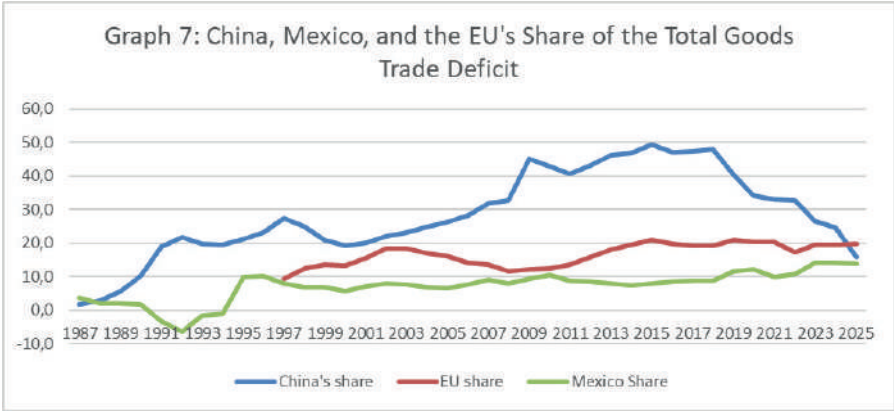
The mid-1960s and mid-1970s represent a turning point. The US trade balance has generally been in surplus or close to balance. However, this situation changed permanently in the mid-1970s, and a period of trade deficits began. There are several fundamental reasons behind this change. These are the collapse of the Bretton Woods System, oil shocks, and the rise of new industrial powers such as the EU and Japan.

The twin deficits phenomenon emerged in the 1980s. The graph shows that the trade deficit (orange and gray lines) deepened significantly in the mid-1980s. Supply-side policies implemented during the Reagan administration (tax cuts and increased defense spending) led to a massive budget deficit. Rising interest rates to finance the budget deficit made the US dollar excessively valuable. The valuable dollar made US exports more expensive while making imports cheaper, resulting in a much higher trade deficit.

The most dramatic deterioration in the graph is seen in the late 1990s and 2000s. The Dot-com Bubble in the late 1990s and the strong domestic demand that followed in the early 2000s were another factor driving imports. This period marked both a peak in globalization and the emergence of China's influence. The trade deficit reached a historic low in 2006, approaching -6 percent of GDP.

Looking at the main reasons for this, we first see China's accession to the World Trade Organization in 2001. This event was a turning point for the global economy. China's massive and low-cost production capacity became fully integrated into the world trading system. From this period onwards, US companies largely shifted their production to China. This flooded the US market with cheap Chinese imports. This situation pushed the goods trade deficit between the US and China to record levels.

Graph 6 shows a sharp contraction (improvement) in the trade deficit during 2008-2009. This does not mean that the US economy experienced a structural improvement. On the contrary, due to the economic crisis, household and corporate consumption and investment demand in the US contracted, and imports were slashed. This is a classic example of how a crisis can temporarily "improve" the trade balance. During the post-crisis recovery process, the deficit began to widen again.



*Source: Data sourced from the U.S. Census Bureau, 2025, and compiled by the author.*

While the US had a \$367 billion goods trade deficit with China in 2015, this graph was \$295 billion in 2024. As shown in Graph 7, since 2015, China’s share of the US’s total goods trade deficit has declined, while its total deficit with the rest of the world has increased, as seen in the previous Graph 6. This shows that the trade deficit has not disappeared, but has only shifted geographically. The main actors filling the gap left by China in this shift have been the European Union and Mexico.

China’s share of the US total goods trade deficit was 49.3 percent in 2015, but this ratio has steadily declined to 24.5 percent in 2024. The US total goods trade deficit was approximately -\$745 billion in 2015, but rose significantly to approximately -\$1.205 trillion in 2024.

As the US’s total deficit increased while China’s share decreased, the trade deficit with other countries or regions must have increased. At this stage, the EU and Mexico stand out.

The U.S. goods trade deficit with the EU was approximately -\$156 billion in 2015, rising to approximately -\$236 billion in 2024. This represents an increase of approximately \$80 billion.

The most striking increase has been in foreign trade with Mexico. The US goods trade deficit with Mexico was approximately -\$60 billion in 2015, but exceeded -\$171 billion in 2024. This represents an increase of more than \$111 billion and makes Mexico one of the biggest winners of the declining US trade deficit with China.

*Table1 : Change in the U.S. Trade Deficit (2015 vs. 2024)*

| Country/Region | Trade Balance<br>2015 (Millions \$) | Trade Balance<br>2024 (Millions \$) | Change in Deficit<br>(Millions \$) |
|----------------|-------------------------------------|-------------------------------------|------------------------------------|
| China          | -367,328                            | -295,515                            | +71,813 (Deficit<br>Decreased)     |
| European Union | -155,900                            | -235,874                            | -79,974 (Deficit<br>Increased)     |
| Mexico         | -59,973                             | -171,491                            | -111,518<br>(Increased)            |
| Canada         | -15,450                             | -61,978                             | -46,528 (Increased)                |
| World Total    | -745,483                            | -1,204,719                          | -459,236 (Net<br>Increase)         |

*Source: Compiled from USA Census Bureau 2025 data and calculated by the author.  
Negative values indicate the US trade deficit.*

Trade data clearly shows the phenomenon of *trade diversion* that emerged as a result of the US-China trade wars, which accelerated in 2018. The tariffs imposed by the US on products imported from China have forced importers and manufacturers to restructure their supply chains. These companies have reduced production in China and shifted production and supply to other countries such as Mexico, the European Union, and even Vietnam, which are not affected by the tariffs.

According to this analysis, although the US trade deficit with China has decreased, it has not disappeared; on the contrary, it has grown further and shifted to other countries, particularly Canada and Mexico due to their geographical proximity and trade agreements (The United States-Mexico-Canada Agreement - USMCA), as well as European Union countries with strong manufacturing infrastructure. Considering the new situation revealed by this picture, it is evident that the U.S.'s foreign trade deficits have not decreased.

### **3.2. How Does the US Finance Its Trade Deficits?**

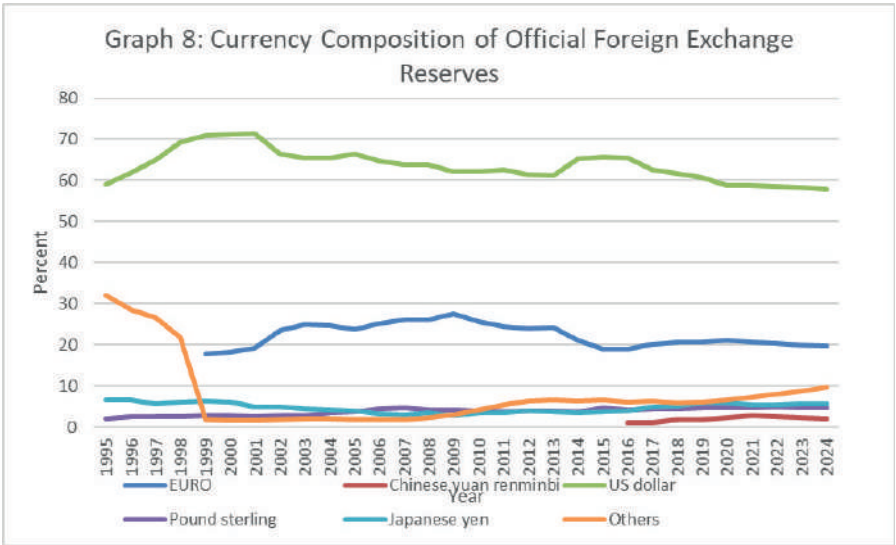
The US trade balance graph shows that the country has had a chronic external deficit problem since the 1970s, primarily stemming from trade in goods. This deficit has been deeply affected by structural transformations such as the collapse of the Bretton Woods system, the “twin deficits” of the 1980s, and the rise of China as a global manufacturing center, as well as cyclical shocks such as the 2008 crisis and the COVID-19 pandemic. In contrast, the US's strong competitive advantage in the services sector creates

a consistent surplus in services trade, which partially offsets this deficit but is insufficient to close it. Therefore, the US finances its trade deficit by running a surplus in the capital and financial account.

The U.S. closes the gap created by purchasing goods and services from the rest of the world by attracting investment from the rest of the world. Foreigners purchase assets in the U.S. rather than goods from the U.S. The main reasons for this capital flow to the United States are listed below.

**3.2.1. The Status of the Dollar as a Reserve Currency**

The US dollar’s status as a reserve currency is the most important factor in this regard. The US dollar is the primary currency for global trade and finance. Central banks of other countries hold large amounts of dollars in their reserves to facilitate international trade and maintain the stability of their own currencies. These central banks purchase U.S. Treasury bonds, the safest and most liquid asset, to invest these dollars (Eichengreen, 2011). This situation provides the U.S. with an “exorbitant privilege”; that is, the U.S. can borrow in its own currency to import goods and services. The rest of the world’s constant demand for dollars enables the US to easily finance its deficits.



Source: IMF, 2025 Created by the author using data from .

Global reserves, which stood at \$1.4 trillion in 1995, peaked at \$12.9 trillion in the 2021-2022 period. There are two main reasons for this

approximately ninefold increase. The first is the 1997 Asian Financial Crisis. During the crisis, Asian countries with insufficient reserves turned to a policy of “prudent reserve accumulation” to protect themselves against similar shocks in the future. Second, the impact of export-driven growth models came into play. A mercantilist approach is at work here. Many developing countries, particularly China, purchased foreign currency (especially dollars) from the market to keep their currencies competitive against the dollar, which led to a rapid increase in their reserves (Aizenman & Lee, 2007).

The most dominant and most debated trend in Graph 8 is the position of the US dollar within the global reserve currency system. Looking at the data, the US dollar still accounts for approximately 58 percent of global reserves, giving it an overwhelming advantage. This situation demonstrates that the dollar continues to enjoy its “exorbitant privilege” (Eichengreen, 2011). The main reasons for this privilege can be listed as: US Treasury bonds being the world’s deepest and most liquid financial market, the dollar being the billing currency in global trade (especially for commodities such as oil), and the inertia (network effect) brought about by the system (Gopinath & Stein, 2021). When examining this trend in detail at , we infer that this hegemony has been slowly eroding (Arslanalp et al., 2022). The dollar’s share, which was around 71 percent in the early 2000s, has now fallen to 58 percent. This 13-point drop is the clearest evidence of a quiet but determined search for diversification in the global system. Central banks do not want to put all their eggs in one basket. The euro and yuan have gained as the dollar has lost ground.

When it was launched in 1999, the euro was expected to be a serious competitor to the dollar, and initially it lived up to this expectation (Chinn & Frankel, 2008). Its share peaked at nearly 28 percent in 2009. However, the Eurozone Debt Crisis (Greece, Spain, etc.) that followed immediately thereafter severely damaged the Euro’s perception as a “safe haven.” Since then, the Euro’s share has fluctuated, settling at around 20 percent. This shows that the Euro has not yet fully realized its potential as a global reserve currency.

The Chinese Yuan (Renminbi), moreover, is gaining strength as a new reserve currency. Included in the graph in 2016, the Yuan had a modest start. Its share began at around 1 percent and has now settled in the 2-2.5 percent range. This small percentage should not be misleading. Considering that China is the world’s largest trading nation and its efforts to internationalize the Yuan (its inclusion in the SDR basket, digital Yuan trials, swap lines), this rise can be seen as the beginning of a long-term trend (Prasad, 2016).

However, the biggest obstacles to the Yuan becoming a fully global reserve currency are China's continued capital controls and the fact that its financial markets are not as transparent and liquid as those in the US.

The "Others" line in Chart 8 tells perhaps one of the most interesting stories. This category includes currencies such as the Australian Dollar, Canadian Dollar, and Swiss Franc. The share of this category has risen from around 2-3 percent in the early 2000s to nearly 10 percent today. This is a "stealth diversification" strategy, showing that central banks are turning not only to the dollar, euro, or yuan, but also to the currencies of smaller economies that are seen as reliable and stable. This is extremely rational behavior in terms of risk management (Arslanalp et al., 2022).

The overall picture revealed by this graph can be summarized as follows:

- a. **The Dollar's Dominance Persists but Is Weakening:** The international monetary system remains dollar-centric, but its strength is diminishing.
- b. **The Transition to a Multipolar Monetary System is Underway:** The world is slowly evolving towards a "multipolar" reserve currency system, where multiple currencies play significant roles, rather than a system where a single rival to the dollar emerges.
- c. **Trust and Liquidity Are Key Priorities:** A currency's reserve status depends not only on the economic size of the country but also on global trust in the depth of its financial markets, the rule of law, and its institutional structures. Levelling-off of the euro's share and the obstacles facing the yuan underscore this reality.

The next decade will reveal how the balances in this picture will be shaped by trade policies, geopolitical tensions, technological developments (digital currencies), and global debt dynamics.

### **3.2.2. High Demand for US Assets**

Foreign investors (individuals, companies, and governments) have a high demand for US assets for various reasons. These can be listed as follows:

**U.S. Treasury Securities:** They are considered the world's safest financial asset. During periods of global economic uncertainty, investors turn to U.S. government bonds, which they view as a "safe haven." This lowers the U.S. government's borrowing costs and facilitates deficit financing (U.S. Department of the Treasury, 2024)

**Foreign Direct Investment (FDI):** Foreign companies make direct investments by establishing factories, acquiring companies, or launching

new operations in the U.S. The U.S.'s large and wealthy market, stable legal infrastructure, and skilled workforce make it attractive for such investments. Between 2000 and 2023, net foreign direct capital inflows to the U.S. reached approximately 1.7 percent of GDP. This value averaged 0.7 percent between 1970 and 1999. Therefore, since the 2000s, the US has pursued more successful policies in attracting foreign capital inflows compared to the previous period. However, since 2015, there has been a relative decline in capital inflows (The World Bank, 2025).

**Portfolio Investments:** Foreigners purchase shares of companies listed on U.S. stock exchanges and private sector bonds. The U.S.'s deep, liquid, and transparent financial markets serve as a global hub for such investments.

### **3.2.3. Economic and Political Stability**

Compared to many other countries, the U.S. is perceived as having strong property rights, a predictable legal system, and political stability. This leads global capital to favor the U.S. for long-term investments. Investors are largely confident that their assets in the U.S. will not be arbitrarily nationalized or lose value.

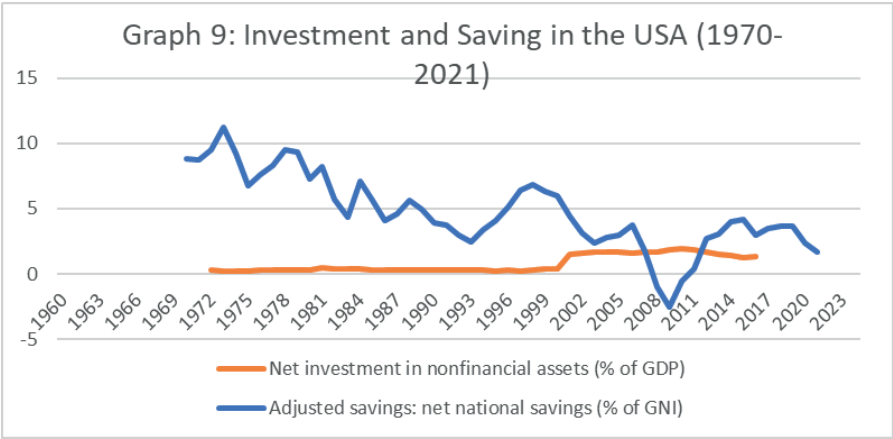
In short, the United States does not “close” its trade deficit; instead, it finances it by continuously attracting capital from the rest of the world thanks to the dollar's status as a global reserve currency, the reliability of U.S. assets, and the depth of the U.S. economy. This is similar to the United States issuing a kind of “debt instrument” (bonds, stocks, etc.) for the goods it consumes. As long as the rest of the world is willing to hold these securities, this system can continue.

In light of this data, it is clear that the US has no problem financing its trade deficits. On the contrary, the US can easily finance its external deficits and at the same time have the opportunity to import in a way that increases consumer welfare. It should also be noted that the US's seigniorage revenues make a significant contribution here.

### **3.3. The Fundamental Problem: Investment and Savings in the United States**

One of the fundamental problems of the United States in this context, which is not very prominent and is not discussed, is its savings and investment trends. Over the last half-century, the U.S. economy has undergone a structural transformation. In particular, there have been significant declines in savings behavior and real capital accumulation. The dollar's status as the global reserve currency, the advantage of seigniorage income, and the ability

to easily import goods with its own currency to increase consumer welfare have come at a cost to the United States.



*Source: The World Bank, 2025 data obtained and compiled by the author.*

Graph 9 shows the trend of two key macroeconomic indicators of the US economy between 1970 and 2021: “Adjusted Net National Savings” as a percentage of Gross National Income (GNI) and “Net Investment in Non-Financial Assets” as a percentage of Gross Domestic Product (GDP). These two indicators are vital for understanding an economy’s long-term growth capacity, capital accumulation rate, and sustainability.

“Adjusted Net National Savings,” shown by the blue line, is a more comprehensive indicator than standard savings measurements. This metric aims to measure a country’s “real” wealth accumulation rate by subtracting depreciation of fixed capital, adding education expenditures, and deducting the damage caused by the depletion of natural resources (energy, minerals, forests) and carbon dioxide emissions (World Bank, 2021).

Graph 9 clearly shows that the US adjusted net national savings rate has entered a long-term downward trend, starting from levels above 10 percent in the 1970s. Various structural factors underlie this decline. Increasing public debt (negative public savings), declining household savings rates, and demographic changes are among the main reasons for this trend.

The most dramatic break in this curve occurred during and after the 2008 Global Financial Crisis (GFC). The fall of the savings rate below zero during the crisis shows that the US economy not only consumed its existing capital and natural resources that year, but also ate into its future prosperity. This

situation is directly related to the massive wealth loss caused by the crisis and the large budget deficits (negative savings) incurred by the government to stimulate the economy (Tooze, 2018). Although there was a recovery in the post-crisis period, savings rates remained well below their historical peaks.

The orange line, “Net Investment in Non-Financial Assets,” represents the net addition to an economy’s physical capital stock, such as factories, machinery, and infrastructure. This is calculated by subtracting depreciation (the wear and tear on capital) from gross investment.

One of the most striking findings shown in Graph 9 is that the net investment rate in the US remained extremely low, almost at zero, from the 1970s to the early 2000s. This indicates that new investments made by the US economy during this 30-year period were only sufficient to offset the depreciation of the existing capital stock. This is an important sign that the country’s infrastructure and production capacity are aging.

This chronic low level of investment aligns with the “Secular Stagnation” thesis, which was brought back into the spotlight by Lawrence Summers (Summers, 2014). According to this thesis, in developed economies, the desired level of investment falls below the desired level of savings due to factors such as demographic reasons, income inequality, and technological changes. This situation leads to low interest rates, slow growth, and asset bubbles. The low net investment rate in the graph can be interpreted as a decline in profitable investment opportunities in the US economy or as companies directing their profits toward financial activities such as share buybacks rather than real investments.

The fundamental macroeconomic identity states that a country’s savings (S) finance domestic investment (I) and net foreign investment (current account surplus) ( $S = I + CA$ ). The large gap between the savings and investment curves in the graph may initially suggest that the US has a large current account surplus. However, this is misleading, as the US has been a country with a chronic current account deficit for decades. The reason for this contradiction is that the “adjusted savings” metric in the graph differs from the standard national accounting definition.

The “excessive privilege” that the dollar has gained from being a reserve currency has shaped the behavior patterns of the US economy. Easy and cheap financing opportunities have weakened the savings discipline of both households and the public sector. This situation is linked to trade deficits through the fundamental macroeconomic identity  $S - I = CA$  (National Savings - Domestic Investment = Current Account). When the U.S.’s

national savings (S) are lower than its domestic investment (I), the current account (CA) must be negative mathematically. This negative balance, i.e., the current account deficit, manifests itself largely through the country importing more goods and services than it exports, i.e., the trade deficit.

The main conclusion comes from reading these two trends together. First, the US is experiencing a low savings and low investment paradox. The US has both a low “real” savings rate and a low net real investment rate. This becomes more meaningful when combined with Ben Bernanke’s “Global Saving Glut” thesis (Bernanke, 2005). According to this thesis, high savings in Asian economies, particularly China, flowed into the US, lowering interest rates and enabling the US to finance its consumption and public spending despite its low savings rate. However, as the graph shows, this foreign capital inflow did not translate into strong real investment growth in the US. Instead, it largely financed consumption and financial assets such as the housing market, paving the way for the 2008 crisis.

Second, long-term growth potential is eroding. According to the Solow growth model, a country’s capital accumulation rate (investment rate) is one of the key factors determining per capita income levels. A net investment rate hovering near zero for decades means that the economy cannot deepen its capital stock and thus weakens its long-term growth potential.

Graph 9 highlights the deep structural challenges facing the US economy over the past 50 years. On the one hand, there has been a steady erosion in adjusted net national savings, which indicate the country’s capacity to build future prosperity. Furthermore, there has been a chronic stagnation in real capital investment, which increases the economy’s production capacity and productivity. The 2008 Global Financial Crisis demonstrated how destructive the combination of these two weaknesses can be. Graph 9 provides strong evidence that the U.S. economy has entered an environment of low growth, low interest rates, and low investment, defined as a “Secular Stagnation,” and highlights the need for the country to prioritize capital accumulation and sustainable savings policies for its long-term economic health.

Is this situation a result of growing trade deficits with China, particularly after 2001, or is it a reflection of the easy financing conditions afforded by the dollar’s status as the global reserve currency?

The answer to this question provides clear evidence as to whether Trump’s policies are right or wrong for the US as of 2025. Let us be clear that the fundamental cause of the structural weakness mentioned above is not trade

deficits, but the dollar's status as the global reserve currency. Trade deficits are a consequence and symptom of this situation.

This analysis reveals that the two factors in question are in a “chicken-and-egg” relationship, but that the fundamental and permissive factor in this dynamic is the “*excessively privileged*” position of the US dollar in the international monetary system. In 1971, US Treasury Secretary John Connally responded to complaints about the negative effects of US economic policies on other countries during a meeting with his European counterparts in Rome by saying, “*The dollar is our currency, but it's your problem.*” (Eichengreen, 2011; . However, today we can say that *the dollar* has become *the US's problem as well*.

The most fundamental mechanism underlying the US's decades-long model of low national savings and high consumption is the situation described as the “exorbitant privilege” (exorbitant privilege) by French Finance Minister Valéry Giscard d'Estaing, which stems from the dollar being the world's primary reserve currency (Eichengreen, 2011, p. 4). This privilege provides the US with two significant economic advantages that no other country possesses:

- **Constant Global Demand:** Central banks around the world need large amounts of dollars to finance international trade, pay their foreign debts, and hold reserves as a store of value. This creates constant demand for financial assets issued by the US, particularly US Treasury bonds, which are considered the world's safest assets, thereby suppressing interest rates.
- **Low Borrowing Costs:** This strong global demand for U.S. assets allows the U.S. government and private sector to borrow at much lower interest rates compared to other countries. This enables the US to sustainably finance its massive budget deficits (negative public savings) and current account deficits (a reflection of low national savings) without triggering a balance of payments crisis. As Eichengreen (2011) points out, while other countries facing deficits of similar magnitude typically experience sharp currency devaluations and interest rate shocks, the US is largely exempt from this mechanism.

In the 2000s, massive savings surpluses generated by export-oriented Asian economies such as China and oil-exporting countries flowed into the US in search of safe havens for investment. This capital inflow further lowered interest rates in the US and enabled it to finance consumption and the housing market despite its low savings rates. This symbiotic relationship

has been defined as a modern system centered on the US, in which Asian economies export capital to the US to sustain export-driven growth, giving rise to the “*Bretton Woods II*” hypothesis (Dooley et al., 2003). In this system, China reinvests the dollars it earns by selling goods to the US into US Treasury bonds; this keeps US interest rates low and strengthens the dollar. Naturally, it also encourages the US to import more from China. Therefore, the trade deficit with China is more a consequence than a cause of this global imbalance system.

Moreover, seigniorage revenue is the key concept that explains how this system works in favor of the US. In its narrow sense, seigniorage is the difference between the nominal value of money and its production cost, but its actual meaning in the international context is much broader. The “international seigniorage” gained by the US consists of real economic advantages stemming from the dollar’s reserve currency status (Eichengreen, 2011). These advantages are as follows:

- **Real Resource Transfer:** The US can obtain real goods and services (imports) in exchange for financial assets (Treasury bonds) denominated in its own currency, which are merely promises of future debt repayment and carry low interest rates.
- **Exemption from Exchange Rate Risk:** The US does not bear any exchange rate risk because it borrows in its own currency. When other countries borrow in foreign currencies, the depreciation of their national currencies increases their debt burdens, but the US is exempt from this risk.

The low savings and investment rates observed in Graph 9 are not a consequence of the US running trade deficits. On the contrary, the “excessive privilege” afforded by the dollar’s status as the global reserve currency is the fundamental and enabling reason that has allowed the US to sustain low national savings rates and high consumption levels for decades. An inevitable consequence of this structural situation and its reflection in the international arena is the chronic trade deficits, financed by the “Global Savings Surplus,” particularly with countries such as China. Therefore, trade deficits are not the disease itself, but rather a symptom of a deeper macroeconomic imbalance created by the dollar’s unique role in the global system.

The other side of the coin is the investments made by US companies in China and other countries that offer cost advantages. In this context, the US is a country that exports significant amounts of capital. Between 1990 and 2023, on average, there has been a net foreign direct investment outflow

equivalent to 1.67 percent of US GDP. This rate was 0.57 percent between the 1970s and 1990. Therefore, US companies have largely turned to net capital exports in the new era of globalization after 1990. Between 2021 and 2024, the amount of net foreign direct investment outflow from the US averaged \$388 billion annually (The World Bank, 2025).

Numerous multinational enterprises (MNEs) have used China as a production base and export platform. Approximately 60 percent of China's exports to the US originate from foreign-owned enterprises. Due to the prevalence of contract manufacturing, some American companies also produce their products in China and export them to the US. Many U.S. technology companies depend on manufacturing facilities in China for the final assembly of their products. For example, 90 percent of the iPhones sold worldwide by U.S. technology giant Apple are assembled in China (Aytekin, 2025). This situation involves trade between a U.S. company (Apple) and its subsidiary or contracted manufacturer in China (e.g., Foxconn), which is a type of intra-company or related-party trade. However, the start of the trade war has begun to shift the direction of cost-focused investments by U.S. companies (Guoyong & Ding, 2021).

#### 4. The Cost of Protectionism

In this new era, led by the US and beginning in 2025, what are the potential effects that customs tariffs on global trade have created so far and will create in the near future? It is possible to answer this question in the context of recent outcomes and economic theory.

The cost of the tariffs imposed by the Trump administration starting in March 2018 has largely been borne not by Chinese exporters, but by US importers and ultimately US consumers and producers. Contrary to the administration's claim that "China will pay these tariffs," economic data from the trade wars that began in 2017 show that the tariffs have effectively created increased costs within the U.S. economy. Tariffs have increased prices since 2018, reducing economic output and employment. Historical evidence that tariffs raise prices and reduce economic growth supports the potential impact of the 2025 tariffs on consumers.

Analyses show that the tariffs of the 2018-2019 trade war were largely borne by consumers of goods imported into the US through higher prices. For example, it was found that after tariffs were imposed on washing machines, washing machine prices increased by \$86 per unit and dryer prices increased by \$92 per unit, resulting in a total cost increase for consumers exceeding \$1.5 billion (York & Durante, 2025).

#### **4.1. Price Impact Mechanism: Nearly Full “Pass-Through”**

Economic analyses have revealed that Chinese exporters did not significantly reduce the dollar prices of the products they sold to the US after the tariffs were imposed. This indicates that the “pass-through” rate was close to 100 percent, meaning that a 25 percent tariff directly increased the cost of the product entering US ports by 25 percent. One of the most fundamental studies on this topic concluded that the cost of the 2018 tariffs was “fully borne by American firms and consumers” and that no statistically significant decline in Chinese firms’ export prices was observed (Amiti et al., 2019).

Increased costs for importers have been passed on directly to retail prices throughout the supply chain. This has occurred in two ways. First, there is a direct impact. The retail prices of Chinese-origin products subject to customs duties (e.g., washing machines, furniture, luggage) have increased significantly. Second, there are indirect effects. Domestic US producers or importers from other countries have tended to raise their own prices as competition pressure has eased due to Chinese competitors losing their price advantage. Estimates of the decline in market revenue understate the total impact Americans will face, as these estimates exclude loss of choice and higher prices for substitute goods. In general, tariffs are trade barriers that raise prices and reduce the current quantity of goods and services available to U.S. businesses and consumers. Tariffs can be passed on to producers and consumers in the form of higher prices. Increases in consumer prices can reduce the after-tax value of both labor and capital, encouraging Americans to work and invest less, which leads to a decline in economic output. In 2026, Section 232 tariffs will reduce after-tax income by an average of 0.3 percent, while IEEPA tariffs will reduce after-tax income by an average of 1.1 percent (York & Durante, 2025).

#### **4.2. Impact on Households**

On the other hand, the cost impact on households also translates to a tax increase. All applied and planned tariffs correspond to an average tax increase of \$1,300 per US household in 2025 and \$1,600 in 2026. These effects directly reduce household purchasing power (York & Durante, 2025). Indeed, the Congressional Budget Office stated that the initial tariffs implemented in 2017 reduced the average U.S. household’s annual real income by approximately \$1,277 due to both higher prices and the reduction in economic efficiency caused by the tariffs (Congressional Budget Office, 2020). Similarly, analyses model that the tariffs will reduce US GDP

by 0.8 percent over a long term such as 2025-2034. They model that it will suppress wage increases and lead to job losses (York & Durante, 2025).

#### **4.3. Impact on Producer and Intermediate Goods Prices**

Tariffs target not only final consumer goods but also critical intermediate goods such as steel, aluminum, and various machine parts used by US manufacturers in their production processes. This has raised raw material prices within the US, particularly due to tariffs imposed on metals such as steel and aluminum. The 2018–2019 experience showed a negative impact on employment and production in the targeted sectors (Flaen & Pierce, 2019). This led to a moderate slowdown in GDP but a more pronounced slowdown in trade.

This increase in costs has negatively impacted the competitiveness of manufacturers in sectors such as automotive, construction, white goods, and machinery manufacturing. With rising raw material costs, US manufacturers have found themselves at a disadvantage against their international competitors in both the domestic market and export markets. The impact of Section 232 (steel and aluminum) and Section 301 (Chinese goods) tariffs imposed by the US on US manufacturers has varied between sectors that received direct protection and industries that use these products as inputs. When examined by sector, Section 232 tariffs have mitigated the damage to the steel industry caused by global overcapacity and encouraged approximately \$22 billion in new capital expenditure by increasing the sector's capacity utilization rate (81 percent in 2021). Similarly, Section 232 tariffs have helped stabilize the primary aluminum industry, with approximately \$5.2 billion in investments announced in the sector since 2018. On the other hand, Section 301 tariffs have reduced imports from China and increased domestic gross production in directly affected sectors such as Semiconductors, Apparel Manufacturing, and Motor Vehicle Parts (with some sectors estimated to have seen increases of up to 6.4 percent in 2021). However, downstream industries that heavily use steel and aluminum as inputs have been negatively affected by rising input costs; studies estimate that most of these industries have experienced a decline in domestic production (up to 2.77 percent in Cutlery and Hand Tool Manufacturing), and downstream domestic prices have increased by an average of 0.2 percent. Therefore, according to the USA Trade Commission report, the tariffs under Sections 232 and 301 have increased input costs for US producers (DeFilippo & Powers, 2023). Some experts also argue that the protectionist policies implemented after 2017 have caused more harm than good to US producers (Lovely & Liang, 2019).

#### **4.4. Overall Economic Impact and Magnitude of Tax Increases:**

The tariffs Trump implemented in 2025 will rank as the largest tax increase since 1993. These tariffs will increase federal tax revenues by \$171.3 billion in 2025. If all IEEPA tariffs remain in effect, the applied tariff rate will rise to 18.9 percent, and the effective tariff rate will rise to 11.6 percent—the highest average rate seen since 1943. Therefore, the 2025 tariffs will not only directly increase household costs but also cause consumers to pay higher prices and have fewer product choices (York & Durante, 2025).

#### **4.5. Global Welfare Loss**

According to Classical Economic Theory, trade wars are events that reduce a country's welfare for three main reasons: 1) Tariffs make imported goods more expensive and reduce consumers' purchasing power, 2) The production costs of domestic producers who use imported goods as intermediate goods increase, and this cost is passed on to consumers, 3) Retaliatory measures reduce external demand for domestic products and decrease production.

#### **4.6. Decline in Global Trade Volume:**

The ratio of global trade to GDP peaked in 2017-2018. During this period, the ratio was around 59-60 percent. This is close to the peak before the 2008 Global Financial Crisis and is an indicator of post-crisis recovery. By 2020, however, this ratio had declined to around 52-53 percent, particularly due to a sharp drop in the first half of the year. Between 2017 and 2020, there was a significant decline of approximately 7-8 points in the share of global trade in the world economy. This means that the global economy has become more “insular” and international trade has slowed down. We anticipate that this trend will continue in the coming period with new customs tariffs. The slowbalization process that began with the policies of 2017 will continue in 2025 and beyond.

#### **4.7. Investment Diversion:**

Trade wars have led to a new restructuring in the global semiconductor value chain, with a “factory-building race” beginning among East Asian economies in particular. The special tariffs imposed by the trade war may encourage MNEs to relocate their production facilities or export bases from high-tariff countries to low-tariff countries, motivated by “tariff jumping/hopping.” This situation has caused potential investments to shift from China to a third country. It is seen as a reflection of the tariffs and protectionist policies that began during the Trump era and continued under the Biden

administration. The policies have encouraged US companies to shift their supply chains from China to other countries seen as “friends and allies.”

#### **4.8. Diversification of the Supply Chain**

Due to increasing risks in recent years, US companies have begun to shift part of their production to countries such as Vietnam and India. However, China still plays a central role thanks to its complex production processes and massive infrastructure (Aytekin, 2025).

Even if some multinational companies move the final product assembly outside of China, they continue to source the raw materials and intermediate parts used in production from China. This again demonstrates trade within the companies’ own supply chains.

Some divestments have resulted from the combined effect of high production costs caused by rising wages and land prices, and higher tariffs caused by the trade war.

A survey of more than 200 American MNEs operating in China showed that 60 percent of companies would adjust their strategies due to the trade war, 50 percent would seek new supply partners, and 25 percent would shift their investments to other countries. There are concrete examples, such as Nintendo, Google, HP, and Dell, showing that US companies (or large MNEs manufacturing in China) are shifting from China to other East/Southeast Asian countries to avoid tariffs and restructure their cost structures. It is noted that US companies initially used China as a major production and export platform due to its cost advantage, but as part of this strategy, investments and production have begun to shift to other Asian countries such as Vietnam, Malaysia, and Taiwan due to the Trade War and increasing tariffs (Guoyong & Ding, 2021).

### **5. Conclusion**

The analysis conducted throughout this section reveals that the US-China trade war, the most debated economic conflict of the 21st century, is an expression of a much deeper and more structural malaise beyond populist rhetoric and headlines. Our fundamental conclusion is that protectionist policies and tariffs represent a misguided treatment based on a flawed diagnosis, targeting not the disease itself but only its most visible symptom: the massive trade deficit. The real issue underlying this conflict is not so much China’s rise as the structural weakness of the US economy over the past half-century, masked by the “exorbitant privilege” conferred by the dollar’s status as the global reserve currency.

As we have demonstrated with data, this “exorbitant privilege” has given the US the unique power to borrow in its own currency to import goods and services from around the world, but on the flip side, it has created a chronic “chronic low-savings/low-net-investment equilibrium” paradox. Easy financing opportunities have led both households and the public sector to prefer consumption over savings and financial speculation over real investment. According to the basic macroeconomic identity ( $S - I = CA$ ), this structure, in which domestic savings fall below domestic investment, mathematically necessitates a current account deficit. In this equation, China, in its role as “the world’s factory,” has become an actor that meets this structural consumption demand of the US and feeds this symbiotic cycle, called “Bretton Woods II,” by reinvesting its dollar surplus in US Treasury bonds. Therefore, the trade deficit with China is not so much a cause of this system as an inevitable consequence.

In this context, the results of the tariffs imposed since 2018 and escalated in 2025 have, as we theoretically expected, pointed to failure. The cost of the tariffs has been borne not by Chinese exporters, but directly by American consumers and producers using intermediate goods through price increases. More importantly, these policies have not reduced the US’s overall trade deficit; on the contrary, they have caused the deficit to shift geographically to other partners such as Mexico and the European Union through the phenomenon of “trade diversion,” and even to increase overall. Rather than solving the fundamental structural problems of the U.S. economy, protectionism has disrupted global supply chains, led to a loss of global prosperity, and accelerated the slowdown in global trade, known as “slowbalization.”

Ultimately, the US-China trade war signals the end of an era. This is not just a competition between two economic superpowers, but also a historic turning point where the sustainability of the dollar-centered global financial architecture and the asymmetric advantages it brings are being questioned. The coming period will show whether the US will confront these structural weaknesses and develop policies to strengthen its real economy by increasing savings and investment rates. For, as the analysis reveals, the words once arrogantly uttered by former US Treasury Secretary John Connally to his European counterparts, “The dollar is our currency, but your problem,” have now become the reality that “The dollar is our currency and now our problem too.” The trade war is nothing more than a noisy confession of this painful truth.

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## Competition Policy and National Interests: Finding Optimal Regulation

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### Abstract

This chapter explores the fundamental tension between competition policy, which aims to ensure market efficiency and neutrality, and the assertion of national interests, which often leads to state intervention. Tracing the evolution of competition law from its ancient roots in Roman and Islamic traditions to the distinct antitrust models of the United States and the European Union, the analysis establishes that this conflict is not new but has been continuously renegotiated throughout history. At the heart of this negotiation lies the Regulated Conduct Doctrine (RCD), a legal principle that exempts conduct compelled by state regulation from competition scrutiny, thereby providing a framework for balancing sovereign prerogatives with market discipline.

The chapter examines two critical contemporary arenas where this tension is most acute. First, it analyzes the regulation of state aid and subsidies, highlighting the clash between the pursuit of “strategic autonomy” in key sectors and the principle of competitive neutrality. Second, it addresses the challenges posed by transnational corporations (TNCs), particularly digital platforms, whose global scale and complex business models defy traditional enforcement. The study details how TNCs use regulatory arbitrage to circumvent oversight and how new instruments like the EU’s Digital Markets Act and Foreign Subsidies Regulation represent innovative responses. The chapter argues that competition policy is not a static legal field but a dynamic area of political economy, concluding that effective governance requires a multi-layered approach combining robust domestic institutions, international cooperation, and a pragmatic balance between industrial policy and competition norms.

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## Introduction

The interaction between **competition policy** and **national interests** constitutes one of the most enduring dilemmas in modern economic governance. On the one hand, competition policy seeks to preserve market efficiency, fairness, and innovation by constraining the exercise of private and public economic power. On the other hand, states frequently invoke national interests—such as strategic autonomy, industrial policy, or security concerns—as grounds to limit or reshape the scope of competition. This duality generates a structural tension: whether markets should be governed primarily by principles of neutrality or by sovereign prerogatives aimed at advancing national objectives

The **Regulated Conduct Doctrine (RCD)** emerges as a pivotal framework for addressing this tension. Rooted in U.S. jurisprudence as the state action doctrine and reflected in the European Union’s regulatory exemptions, RCD embodies the principle that conduct compelled by legitimate regulatory frameworks may be exempted from competition law scrutiny. While this doctrine safeguards firms from being penalized for obeying regulatory mandates, it also raises concerns of regulatory capture, market foreclosure, and conflicts with supranational competition norms. Thus, the RCD illustrates both the **necessity and risks** of reconciling national regulatory choices with competition law enforcement.

The interaction of national interests and competition policy produces a series of **systemic challenges**. When governments rely on subsidies, protective regulations, or exemptions to advance strategic sectors, they risk undermining the competitive neutrality that sustains open markets. Conversely, an overly rigid application of competition law may constrain states from pursuing legitimate developmental or security goals. These conflicts are especially visible in areas such as state aid, foreign subsidies, and the regulation of transnational corporations. The study therefore engages with the fundamental question of how competition law can discipline market distortions without eroding the sovereign capacity to safeguard national priorities

Building on this tension, the **central hypothesis** of the study is that competition policy is not a static legal framework but a **dynamic negotiation between neutrality and sovereignty**. It argues that while competition law traditionally aimed to neutralize private restraints, its contemporary function increasingly extends to disciplining state interventions, subsidies, and industrial strategies. A secondary hypothesis holds that the growing role of digital platforms and transnational corporations has redefined the

boundaries of this negotiation, demanding new hybrid instruments that merge competition law with elements of industrial and trade regulation.

The study proceeds in several stages. The first section traces the **historical evolution of competition law**, from ancient and classical roots to the constitutional struggles of the early modern period and the distinct traditions of U.S. antitrust and EU competition policy. The second section examines the **role of state aid and subsidies**, analyzing their conceptual foundations, contemporary debates over strategic autonomy, and the mechanisms used to discipline their distortive effects. The third section focuses on **transnational corporations**, exploring both the challenges they pose for traditional enforcement and the new regulatory instruments designed to resist their circumvention strategies. Finally, the study advances a set of **policy recommendations**, emphasizing the importance of domestic institutional resilience, international cooperation, and the careful reconciliation of industrial policy with competition norms

In conclusion, the study underscores that competition policy cannot be understood merely as a technical legal regime; it is a field of **contested political economy**. Its effectiveness depends on balancing the imperatives of open markets with the legitimate pursuit of national and collective interests. The analysis suggests that only through adaptive, multi-level governance can states prevent competition law from either becoming a shield for protectionism or a straitjacket against legitimate state action.

## 1. The Historical Evolution of Competition Law and Policy

Competition law and policy occupy a distinctive place in modern governance, shaping not only market transactions but also the legal, economic, and political foundations of society. Far from a technical regime, it reflects enduring concerns with power, fairness, and the conditions of liberty in commercial life (Ezrachi & Stucke, 2016, pp. 12–18).

Its intellectual roots lie in diverse traditions: **Aristotle's** *commutative justice* framed exchange as a matter of reciprocity; **Roman law** condemned grain hoarding as a civic wrong; and the **Islamic hisba** entrusted market supervision to moral and religious duty (Müller, 2014; Rostovtzeff, 1957). These strands converged with **medieval and early-modern struggles** over monopoly and privilege, culminating in the **Statute of Monopolies (1624)**, which limited royal prerogative and placed competition under parliamentary authority (Letwin, 2013, pp. 53–60).

In the **United States**, antitrust law emerged as a response to industrial trusts, with the **Sherman Act (1890)** construing monopolization as a threat

to both consumer welfare and democratic self-rule (Thorelli, 1955, pp. 154–163). The **European Union**, by contrast, bound competition policy to the project of integration, embedding market freedom within a supranational constitutional order (Gerber, 1998b, pp. 350–365).

Intellectual currents from **Smith** to **Schumpeter** and **Hayek** supplied the analytical categories—efficiency, innovation, consumer welfare—that continue to shape enforcement and policy. Competition law thus emerges as a **longue durée institution**, continually renegotiating the boundary between state authority and market freedom, distributive fairness and allocative efficiency, static price control and dynamic innovation.

### 1.1. Ancient and Classical Roots

The origins of competition regulation can be traced back over three millennia, to the early practices of city-states where markets were inseparable from social order and political authority. In **Mesopotamia**, the *Code of Hammurabi* (c. 1750 BCE) imposed ceilings on prices and wages as a mechanism to stabilize fragile agrarian production and to shield dependent classes from exploitation. By linking exchange to distributive justice, the code redefined profiteering: no longer regarded as a natural corollary of scarcity, it was condemned as a transgression against collective stability and civic peace (Finley, 1985, pp. 17–22).

In **Classical Athens**, grain markets—vital for subsistence—were subject to direct criminal regulation. Cartelization among grain traders was prosecuted as a public wrong, reflecting the polis’s conviction that collusion endangered not only economic efficiency but also the survival of its citizens. By treating collective manipulation of staples as an affront to civic order, Athenian law embedded the principle that market fairness was a legal and moral obligation rather than a matter of private contract (Bresson & Rendall, 2016, pp. 245–252; Cohen, 1992, pp. 83–89).

The **Roman experience** extended and institutionalized these instincts. The *Lex Iulia de Annona* targeted hoarding and artificial restriction of grain supplies, while the regulated *collegia* (guild-like associations) were designed to prevent abuses within organized trades. The culmination came with **Diocletian’s Edict on Maximum Prices (301 CE)**, an ambitious empire-wide wage-and-price schedule intended to halt inflation and secure provisioning across the provinces. Although enforcement proved largely unworkable, the edict exemplified a recurring regulatory reflex: when the satisfaction of basic needs was at risk, imperial authority asserted itself by capping prices and disciplining markets (Rostovtzeff, 1957, pp. 312–318).

Viewed collectively, these episodes reveal a **civilizational pattern**: from Mesopotamian codes to Athenian prosecutions and Roman edicts, early societies repeatedly intervened to ensure that markets remained compatible with subsistence and social order. In each case, competition regulation was not a peripheral technicality but a foundational element of governance, embedding principles of fairness and stability into the earliest frameworks of economic life.

## 1.2. Asian and Islamic Contributions

The intellectual and institutional history of competition regulation is not confined to the West. Long before the emergence of modern antitrust, Asian and Islamic traditions elaborated regulatory mechanisms that combined political authority with moral philosophy.

In South Asia, Kautilya's *Arthaśāstra* (3rd c. BCE) stands out as both a treatise on statecraft and an administrative manual. Far from advocating laissez-faire, it treated markets as strategic domains of governance. The text prescribes inspections of weights and measures, penalties for fraudulent traders, and calibrated controls over vital commodities such as salt, metals, and forest produce (Olivelle, 2013, pp. 215–228). Monopoly rents, rather than being tolerated as rewards to private enterprise, were viewed as instruments that the state could harness, discipline, or redistribute in the interest of fiscal capacity and social welfare. Modern scholarship has thus interpreted the *Arthaśāstra* as evidence of an early awareness that unchecked private dominance could threaten both stability and legitimacy of rule.

A comparable tension is evident in **Han China**, most famously in the *Salt-and-Iron Debates* of 81 BCE. These debates brought Confucian scholars into direct confrontation with Legalist administrators over the state monopolies in salt and iron. The Confucians condemned monopolization as corrosive to the moral order and oppressive to the agrarian population, arguing that market exchange must remain subordinate to ethical norms and the sustenance of households. The Legalists, by contrast, defended monopolies as legitimate tools of imperial prerogative, essential for financing military campaigns, infrastructure, and the stabilization of prices in times of scarcity (Ebrey, 1981; Lewis, 2007, pp. 120–127). These deliberations prefigure modern controversies over industrial policy and market liberalization, highlighting how questions of competition were entangled with broader concerns of revenue, security, and distributive justice.

The **Islamic tradition** developed its own distinctive regulatory idioms through the institution of the *hisba*. Rooted in the Quranic imperative of

promoting right and forbidding wrong, the *hisba* functioned as a mechanism for market oversight, with the *muhtasib* (market inspector) charged with enforcing fair weights and measures, preventing fraudulent practices, and sanctioning exclusionary conduct. Thinkers such as **al-Ghazālī** emphasized that fairness in trade was a religious obligation tied to the moral accountability of merchants, while later jurists like **Ibn Taymiyyah** elaborated doctrines condemning monopoly and unjust enrichment as violations of communal welfare (Kalyoncuoğlu, 2021; Müller, 2014; Töre Sivrioğlu, 2013). By embedding commercial regulation in a moral and religious framework, Islamic law construed competition not merely as an economic process but as a matter of justice, communal solidarity, and ethical governance.

Taken together, these traditions reveal a striking convergence: from South Asian statecraft and Chinese policy debates to Islamic market supervision, diverse civilizations recognized that the unchecked pursuit of gain could destabilize society. Across cultural and temporal contexts, regulation of competition was framed as a necessary expression of political authority and moral responsibility, embedding ideals of fairness, subsistence, and order into the very foundations of economic governance.

### 1.3. Early-Modern Limits on Monopoly Privilege

The early-modern period marked a decisive turning point in the genealogy of competition regulation, as questions of monopoly and restraint of trade became entangled with constitutional struggles over the limits of royal prerogative. In **England**, the Tudor and Stuart monarchs relied extensively on exclusive patents and royal charters, often granted as fiscal expedients or political favors. These privileges aroused widespread resentment, as they inflated prices, restricted entry into trades, and generated rents at the expense of consumers and common producers (Coke, 2003).

The backlash crystallized in the celebrated **Case of Monopolies (Darcy v. Allen, 1602)**, in which the courts struck down a crown-granted sole right to manufacture playing cards as void against the common law. The decision denounced monopolies as contrary to liberty and trade, embedding a principle that economic privilege could be judicially limited in the interest of the commonwealth (Darcy v. Allen, 11 Co. Rep. 84b, 77 ER 1260). This judicial stance was codified in the **Statute of Monopolies (1624)**, which invalidated most forms of monopoly while preserving only narrow invention patents of limited duration. The Statute shifted regulatory authority over markets from prerogative to Parliament, entrenching a presumption in favor of competitive access and against exclusive privilege (Fisher, 2010).

These English developments occurred within a broader **European mercantilist context**, where states oscillated between granting protective monopolies to stimulate nascent industries and dismantling privileges to encourage free trade. The tension is visible in France, Spain, and the Low Countries, where monopoly was alternately deployed as an instrument of strategic capacity-building and condemned as a source of rent-seeking and stagnation (Viner, 1960, pp. 42–49). Such oscillations underscore a fundamental dilemma: whether concentrated economic power could serve as a tool of statecraft or whether it inevitably subverted the principles of open competition.

At the level of political economy, the critique of monopoly was systematized by **Adam Smith**, who argued that *“people of the same trade seldom meet together... but the conversation ends in a conspiracy against the public”* (Smith, 2022). For Smith, monopoly was both economically inefficient and politically dangerous, demanding vigilance through legal and institutional checks.

Thus, the early-modern period forged enduring legal categories—*restraint of trade, exclusive privileges, patents*—that would later be redeployed by modern competition law with greater economic sophistication. More importantly, it established a constitutional logic: that monopoly was not merely an economic aberration but a political problem implicating liberty, legitimacy, and the proper boundaries of sovereign power.

#### 1.4. United States Antitrust Policy

The emergence of antitrust law in the United States during the late nineteenth century marked the transition from traditional prohibitions on monopoly to a systematic legal regime designed to discipline private concentrations of economic power. Unlike earlier interventions that primarily targeted state-granted privileges, U.S. antitrust confronted the rise of vast industrial trusts and corporate combinations that threatened both market competition and democratic governance.

The foundational statute, the **Sherman Antitrust Act of 1890**, reflected a combination of populist, republican, and economic concerns. It declared illegal “[e]very contract, combination...or conspiracy, in restraint of trade” and made monopolization a federal offense (Thorelli, 1955, p. 154). The Act was intended not merely as an economic measure but as a safeguard of political liberty, echoing fears that unchecked corporate power could corrupt markets and undermine republican institutions.

Early Supreme Court jurisprudence sought to interpret this broad statutory language. In **Standard Oil Co. v. United States (1911)**, the Court articulated the “rule of reason”, holding that only unreasonable restraints of trade violated the Sherman Act (*Standard Oil Co. of New Jersey v. United States*, 221 U.S. 1 (1911), 1911). This principle gave courts flexibility but also introduced enduring debates about the scope of antitrust. Around the same time, **United States v. American Tobacco Co. (1911)** reinforced the idea that monopolization was unlawful when accompanied by exclusionary conduct and structural dominance (*United States v. American Tobacco Co.*, 221 U.S. 106 (1911), 1911).

Congress supplemented the Sherman Act with the **Clayton Act of 1914**, targeting specific anticompetitive practices—mergers, exclusive dealing, tying arrangements, and interlocking directorates—at an incipient stage. The same year, the **Federal Trade Commission Act** established the FTC and prohibited “unfair methods of competition”, thereby introducing a flexible administrative instrument to complement judicial enforcement (Kovacic & Shapiro, 2000).

From the New Deal through the mid-twentieth century, U.S. antitrust embraced a **structuralist orientation**, emphasizing the preservation of rivalry and dispersal of economic power. Courts adopted strong presumptions against horizontal mergers, vertical restraints, and resale price maintenance, seeing concentrated structures as inherently threatening to competition (Hofstadter, 1991).

Beginning in the 1970s, however, antitrust doctrine underwent a **Chicago School transformation**. Scholars such as Robert Bork and Richard Posner argued that the purpose of antitrust was the maximization of consumer welfare, measured primarily through price and output effects (Bork, 1978; Posner, 1976). Courts adopted this reasoning, narrowing the range of practices deemed anticompetitive and emphasizing administrability, efficiency, and the avoidance of “false positives”.

More recently, **Post-Chicago economics** has challenged these simplified models, reintroducing concerns about strategic behavior, foreclosure, and dynamic harms, particularly in the context of innovation and digital platforms (Hovenkamp, 2020, pp. 75–76). Contemporary debates center on how to adapt traditional antitrust tools to two-sided markets, network effects, and the data-driven economies of scale that characterize the digital age.

In sum, U.S. antitrust developed along a trajectory from populist distrust of concentrated power, to judicial balancing under the rule of

reason, to structural preservation of rivalry, and finally to economically calibrated standards focused on consumer welfare. Each stage reflects shifting conceptions of competition, efficiency, and fairness, demonstrating that American antitrust has always been as much a political project as an economic one.

### 1.5. European Union Competition Policy

Competition policy in the European Union evolved as both an economic instrument and a constitutional commitment. Unlike the United States, where antitrust emerged primarily as a response to private concentrations of power, the EU embedded competition law within the very framework of integration. From the outset, the objective was not only to preserve rivalry but also to secure the functioning of the common market, prevent economic fragmentation, and consolidate the political project of European unity.

The **Treaty of Rome (1957)** enshrined competition provisions in Articles 85 and 86 (now Articles 101 and 102 TFEU). Article 101 prohibits cartels and concerted practices that restrict competition, while Article 102 targets abuses of dominant position. These provisions were distinctive because they were drafted not as national statutes but as **supranational constitutional commitments**, directly applicable in Member States (Gerber, 1998a, pp. 350–365).

The **European Commission** became the central enforcement authority, endowed with investigatory, prosecutorial, and decisional powers. This administrative model contrasted with the U.S. reliance on private litigation and judicial development. By placing competition law in the hands of a supranational regulator, the EU emphasized consistency, integration, and fairness in market access (Korah, 2007).

The EU system has historically reflected the influence of **ordoliberalism**, a German intellectual tradition that views competition as a constitutional order necessary to restrain both private and public power. Ordoliberal thought insists that economic freedom is inseparable from political freedom, and that the state has a duty to secure the “competitive process” itself rather than merely maximize consumer welfare (Gerber, 1994). This orientation explains the EU’s persistent emphasis on exclusionary conduct and structural distortions, even where short-term price effects are ambiguous.

Over time, the EU system has evolved. The **Merger Regulation (1989, revised 2004)** introduced centralized merger control to prevent

structural concentrations inconsistent with the single market.<sup>3</sup> The **State Aid rules**, codified in Article 107 TFEU, discipline distortive subsidies and reinforce competitive neutrality between firms across Member States (Fox & Gerard, 2017). The **Modernization Regulation (Regulation 1/2003)** decentralized enforcement by empowering national competition authorities and courts while maintaining coherence through the European Competition Network (Ehlermann, 2000, pp. 141–152).

More recently, debates have intensified over how to adapt EU competition law to **digital markets**, characterized by network effects, self-preferencing, and data-driven market power. The **Digital Markets Act (2022)** represents a quasi-regulatory supplement to traditional antitrust enforcement, imposing ex-ante obligations on large digital “gatekeepers” to ensure contestability and fairness (European Commission, 2022). Taken together, EU competition law reflects a hybrid identity: it is simultaneously a technical body of economic regulation, a constitutional safeguard for the single market, and an expression of a broader European political project. Its distinctive orientation—shaped by ordoliberal principles, administrative centralization, and supranational integration—underscores the divergence from the U.S. model and highlights the plurality of paths through which competition law has been embedded into modern governance.

## 1.6. Economic Thought and Contemporary Challenges

The trajectory of competition law cannot be disentangled from the history of economic thought. The very categories through which courts and policymakers have conceptualized “competition,” “monopoly,” and “restraint of trade” were forged in intellectual debates that stretch from classical political economy to modern industrial organization theory.

The **classical economists**—most notably **Adam Smith** and **David Ricardo**—conceived of markets as self-regulating systems in which the pursuit of individual interest could, under conditions of rivalry and openness, generate socially beneficial outcomes. Smith’s famous claim that *“people of the same trade seldom meet together... but the conversation ends in a conspiracy against the public”* remains one of the earliest systematic recognitions of collusion as an endemic threat to market order (Smith, 2022). Ricardo and his successors extended this logic, emphasizing the dangers of rent extraction through monopoly privileges and trade restrictions, while simultaneously advocating for free trade as the engine of comparative advantage (Ricardo, 2008). These arguments reinforced legislative movements in Britain and

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3 Council Regulation (EC) No 139/2004.

the United States to abolish exclusive charters and to codify rules against monopolistic restraint.

The **neoclassical revolution** of the late nineteenth century transformed this framework by introducing formal models of supply, demand, and equilibrium, thereby enabling a more precise definition of “perfect competition” as a benchmark against which market conduct could be judged. The emergence of welfare economics provided antitrust with an analytical vocabulary—efficiency, consumer surplus, and deadweight loss—that continues to structure debates today (Marshall, 1890).

In the **mid-twentieth century**, antitrust enforcement in the United States was shaped by a **structuralist paradigm**: concentrated market structures were viewed as inherently conducive to collusion and exclusion, justifying strict prohibitions on mergers, tying arrangements, and vertical restraints. This approach resonated with the New Deal ethos of dispersing economic power to preserve democratic values (Hofstadter, 1991, pp. 60–65).

The subsequent **Chicago School** marked a decisive shift. Figures such as **Robert Bork** and **Richard Posner** argued that antitrust should abandon diffuse political or fairness-based goals and instead focus narrowly on **consumer welfare** as measured by price and output. In their view, many practices previously condemned—vertical restraints, exclusive dealing, even certain forms of predatory pricing—could often be efficient and pro-competitive. This approach, articulated in Bork’s (1978) *The Antitrust Paradox* and Posner (1976) *Antitrust Law* (1976), came to dominate U.S. jurisprudence from the late 1970s onward, leading to a significant contraction in enforcement activity.

Yet the **Post-Chicago school**, emerging in the 1980s and 1990s, contested the Chicago orthodoxy by emphasizing the potential for **strategic behavior and dynamic harms**. Through game theory and new industrial organization models, scholars demonstrated that predatory pricing, exclusive contracts, and vertical integration could, under realistic conditions, foreclose rivals, deter entry, and reduce long-term innovation (Salop & T. Scheffman, 1983).

These theoretical currents shape the **contemporary challenges** of competition law in both the United States and the European Union. The rise of **digital platforms**—search engines, social media, and online marketplaces—has exposed the limitations of price-centric metrics. Network effects, data-driven feedback loops, and platform ecosystems create forms of dominance that may harm innovation, privacy, and democratic discourse

even in the absence of traditional price increases (Farrell & Shapiro, 2010). These developments have catalyzed a renewed global debate over whether antitrust should integrate broader concerns of **fairness, pluralism, and political economy** alongside efficiency.

Thus, the evolution of economic thought—from classical political economy through Chicago and Post-Chicago economics—has continuously redefined the normative and analytical foundations of competition law. What began as a moral injunction against monopoly power has become an ongoing struggle to reconcile efficiency, fairness, and democratic legitimacy in the governance of markets. The contemporary digital economy, with its unprecedented concentration of data and intermediation, ensures that this intellectual dialogue remains unfinished, pressing regulators to revisit fundamental assumptions about what it means for markets to be “competitive.”

## 2. State Aid and Subsidies: a Competition Regulation Perspective

The regulation of state aid and subsidies illustrates one of the most complex frontiers in competition law. Unlike classical antitrust problems—cartels, mergers, abuse of dominance—where the state acts as an enforcer, here the state itself is the source of distortion. Subsidies, by definition, involve the transfer of public resources to favored undertakings, altering cost structures and competitive dynamics. This dual character—public purpose versus market distortion—explains why state aid occupies such a contested position in modern governance (Khan, 2017).

Historically, subsidies were regarded as **sovereign prerogatives**, part of the fiscal and industrial arsenal of rulers. Mercantilist states in early modern Europe dispensed privileges, export bounties, and tax exemptions in pursuit of national wealth and military power (Viner, 1937). The rise of globalized markets, however, transformed subsidies into **competitive weapons**, capable of tilting not only domestic but also international competition. As a result, subsidy control migrated from the realm of political economy into the architecture of competition law.

Today, the stakes are acute. Subsidies underpin strategic industrial policies—from semiconductors to green technologies—yet they also provoke fears of subsidy wars, protectionism, and fiscal waste. The challenge for regulators is to reconcile two imperatives: the **legitimacy of state intervention** in pursuit of collective goals, and the **integrity of competitive neutrality** as the foundation of market economies (Fox & Gerard, 2017).

## 2.1. Conceptual Foundations

From the perspective of competition regulation, **state aid and subsidies** are a conceptual anomaly. They do not fit neatly into the standard antitrust categories of cartels, mergers, or abuse of dominance, since their origin is not private market conduct but **public authority**. Yet their economic effects—distorted prices, altered cost structures, entry deterrence—mirror those of private restraints. This dual character has produced divergent scholarly and policy perspectives on how subsidies should be classified, disciplined, and justified.

**The economic perspective** emphasizes the welfare analysis. Classical and neoclassical economists tend to view subsidies as **allocative distortions** that create deadweight losses and sustain inefficiency. Subsidies may prop up “zombie firms” or shield incumbents from competitive pressure, producing long-term stagnation (Baumol & Blinder, 2015). By contrast, developmental and heterodox economists stress the **corrective potential of subsidies**: by addressing underinvestment in public goods such as research and development, education, or environmental protection, subsidies can enhance dynamic efficiency and long-term growth (Rodrik, 2004). Thus, even within economics, subsidies oscillate between being classified as “distortions” and as “remedies for market failure.”

**The legal perspective** approaches subsidies through the prism of **competitive neutrality**. In EU law, state aid is presumptively incompatible with the internal market under Article 107(1) TFEU, yet it may be exempted if it serves broader policy objectives and passes proportionality tests (Quigley, 2015). This framework reflects the conviction that competition law must constrain state discretion to prevent fragmentation of the single market. Conversely, in many non-EU jurisdictions, subsidies remain largely within the sphere of **industrial policy**, only indirectly scrutinized under trade law or procurement rules (Gerber, 1998b).

**The political perspective** highlights the sovereignty dimension. For some scholars, subsidies are legitimate expressions of democratic choice, allowing states to pursue social goals—employment, regional development, or strategic autonomy—even at the cost of efficiency. Others argue that **unchecked** subsidies erode the principle of **equality before the law**, replacing competition on the merits with government favoritism and clientelism. In this sense, subsidies test the boundary between the state as a neutral regulator and the state as an active market participant.

Finally, **international trade and competition perspectives** converge on the idea that subsidies must be disciplined because their **spillover effects** extend beyond national borders. The WTO's Agreement on Subsidies and Countervailing Measures (SCM Agreement) embodies this logic. According to WTO rules, subsidies may be permissible domestically, but if they harm foreign producers, they are treated as actionable or prohibited (Sykes, 2003). From this vantage point, subsidies are not just national economic tools but sources of international **competitive imbalance**.

Taken together, these perspectives illustrate why subsidies remain one of the most contested concepts in competition regulation. Economists debate their efficiency, lawyers debate their legality, and policymakers debate their legitimacy. The common denominator, however, is the recognition that subsidies implicate **fair competition** no less than private restraints of trade, making them central to the broader project of regulating market order.

## 2.2. Contemporary Debates: Strategic Autonomy vs. Competitive Neutrality

In contemporary competition regulation, the most acute controversies surrounding state aid and subsidies arise at the intersection of **digital transformation, climate policy, and geopolitical rivalry**. Industrial policies that channel vast public resources into semiconductors, renewable energy, artificial intelligence, or electric vehicles are defended as indispensable responses to systemic vulnerabilities brought by global supply chain fragility, climate imperatives, and strategic dependence on foreign actors (European Commission, 2022).

The concept of **strategic autonomy** has thus gained prominence, particularly in the European Union. It reflects the argument that certain sectors are too critical to be left to global market forces and must be protected or nurtured through targeted subsidies, even at the cost of strict neutrality. The United States' **CHIPS and Science Act (2022)** and the EU's **Green Deal Industrial Plan (2023)** illustrate this new paradigm, where subsidies are deployed not only as economic correctives but as tools of resilience and security.

From a competition law perspective, however, this shift provokes serious concerns. If every jurisdiction invokes strategic autonomy to justify subsidies, the cumulative effect may be a **subsidy race**—a spiral of protectionism that undermines the very principles of open and competitive markets. Critics warn that subsidies granted in the name of resilience can quickly degenerate

into disguised protection, shielding domestic firms from global rivalry and entrenching inefficiencies (Sykes, 2003).

The Chinese experience further complicates this debate. China's model of state-led industrial policy—especially in steel, solar panels, and high-tech sectors—has amplified geopolitical anxieties, prompting the EU and U.S. to recalibrate their competition frameworks to address the competitive distortions posed by foreign subsidies (Gao, 2021). In response, instruments such as the **EU Foreign Subsidies Regulation (2023)** aim to extend competition law to scrutinize the global competitive effects of third-country subsidies.

The contemporary debate, therefore, crystallizes a fundamental dilemma: should competition law prioritize **neutrality and efficiency**, or should it accommodate **strategic industrial policy** in the service of sovereignty, security, and sustainability? The outcome will define not only the trajectory of state aid control but also the future balance between **open markets and economic nationalism** in global governance.

### 2.3. Approaches to Addressing the Negative Effects of Subsidies

From the perspective of competition policy, regulators have developed a variety of strategies to mitigate the adverse effects of subsidies while still allowing states a degree of policy autonomy. These approaches reflect different institutional logics—judicial, administrative, and trade-based and reveal how legal orders attempt to reconcile state intervention with market fairness.

**The *Ex-ante* control through authorization** exemplifies the model chosen by the European Union (EU). If Member States decide application of aid measures, they must notify proposed aid measures to the European Commission, which assesses their compatibility with the internal market under Articles 107–109 TFEU. The Commission's ability to authorize, condition, or prohibit aid ensures that distortive measures are filtered before they take effect. This preemptive mechanism reduces fragmentation of the single market while preserving exceptions for legitimate policy goals such as regional development or green transition (Quigley, 2015).

**As the second option *Ex-post* discipline is ensured through application of countervailing measures.** In international trade law, the WTO's SCM Agreement allows Members to impose countervailing duties when another state's subsidies cause material injury to domestic industry. This approach accepts that subsidies may exist but seeks to neutralize their impact on competition through corrective tariffs. The Airbus/Boeing disputes illustrate

both the effectiveness and the limits of this mechanism, as prolonged litigation and retaliatory measures often delay meaningful correction (Gao, 2021).

A more nuanced approach focuses not on banning subsidies outright but on evaluating their **necessity and proportionality through application of proportionality and conditionality tests**. Aid is deemed permissible if it addresses a well-defined market failure, is limited to the minimum necessary, and avoids excessive distortions of competition. This analytical framework, now embedded in EU state aid guidelines and OECD recommendations, reflects a shift toward **effect-based analysis** rather than categorical prohibitions (Nicolaidis, 2015).

It should also be emphasized that a major global development in this field is the growing insistence on **transparency and accountability in the authorization of state aid schemes**. Rather than relying exclusively on prohibitions or Ex-post remedies, regulators increasingly demand that aid measures be disclosed to the public as a condition of legitimacy. Such transparency functions as an additional layer of discipline: by making state interventions visible, it empowers competitors, consumers, and civil society to scrutinize, contest, or monitor their effects. The **EU's transparency register** and the **WTO's subsidy notification system** illustrate this shift, signaling that effective subsidy control depends not only on formal legal mechanisms but also on informational checks and reputational pressures that constrain states through openness (Gerber, 1998b).

Finally, recent regulatory innovations demonstrate how competition law is being **extended beyond national borders** in response to the globalization of subsidies. The **EU's Foreign Subsidies Regulation (2023)** represents a landmark in this evolution, empowering the Commission to investigate and remedy distortions caused by state support originating outside the Union—an area previously beyond the reach of internal competition law and left largely unaddressed by the stalemated WTO framework. This development points toward the emergence of **hybrid regulatory instruments** that fuse elements of competition, trade, and industrial policy, reflecting a recognition that in an interconnected economy, the distortive effects of subsidies cannot be contained within national jurisdictions (Gao, 2021).

State aid and subsidies epitomize the **structural tension** between the prerogatives of sovereign intervention and the imperatives of competition regulation. They operate simultaneously as instruments of **industrial strategy**—capable of correcting market failures, fostering innovation, and enabling green or digital transitions—and as vectors of **market distortion**,

privileging select firms, entrenching incumbents, and fragmenting markets. This duality ensures that subsidy control cannot be reduced to either absolute prohibition or unchecked permissiveness, but must instead be understood as a **dynamic negotiation between legitimacy and distortion**.

Modern legal orders have institutionalized this negotiation through diverse mechanisms: the **EU's ex-ante notification and authorization system**, which pre-emptively disciplines national interventions; the **WTO's countervailing measures regime**, which seeks to neutralize cross-border spillovers; and **emerging hybrid instruments**, such as the EU's Foreign Subsidies Regulation (Regulation (EU) 2022/2560 of the European Parliament and of the Council of 14 December 2022 on Foreign Subsidies Distorting the Internal Market, 2022), which extend scrutiny to globalized subsidy practices. Each reflects a broader recognition that competition law must evolve to confront the reality of subsidies as **transnational distortive forces**, not merely domestic policy tools.

Yet the **central normative dilemma remains unresolved**. Should competition law position itself as the uncompromising guardian of neutrality, insulating markets from all forms of state favoritism? Or should it accommodate **strategic subsidies** in the name of sovereignty, resilience, and sustainability, particularly in an era of climate crisis and geopolitical rivalry? This dilemma transcends technical regulation: it raises fundamental questions about the **constitutional role of markets** in liberal democracies and the permissible scope of **economic nationalism** within a globalized order.

The trajectory of subsidy regulation will therefore shape not only the **contours of competition law**, but also the broader balance between state power and market freedom, between the demands of global integration and the pressures of domestic legitimacy. In this sense, the governance of state aid and subsidies stands as a litmus test for the future of economic regulation in the twenty-first century.

### 3. Transnational Corporations and Competition Policy

Transnational corporations (TNCs) are now central actors in shaping global trade, investment, supply chains, and innovation. Their cross-border presence grants them enormous market power, generating both opportunities for growth and risks of distortion. Competition policy must therefore ensure that markets remain fair, contestable, and conducive to innovation, while adapting to the increasingly complex practices of global firms. This tension is particularly acute in the digital economy, where e-commerce platforms

and social networks have become structural “gatekeepers” of information, transactions, and consumer access.

In the past decade, large platforms such as Amazon, Meta, Google, and Alibaba have consolidated positions that enable them to operate simultaneously as intermediaries, sellers, advertisers, and data controllers. This convergence of roles creates inherent conflicts of interest, especially through **self-preferencing** practices, whereby platforms prioritize their own products or services in search and recommendation rankings. Scholars have shown that such structural conflicts threaten market contestability and raise welfare concerns. The debate on whether structural separation of advertising and marketplace functions would benefit consumers remains unsettled, with some models suggesting ambiguous welfare effects (Rekabet Kurumu, 2023).

A further concern is the increasing use of **algorithmic pricing and machine learning**. Automated systems can lead to tacit collusion, higher prices, and consumer lock-in even without explicit agreements. The OECD has warned that traditional legal frameworks may be insufficient to capture such “invisible” harms in digital markets (Deng, 2020).

Another visible trend is the rise of **instant retail and ultra-fast delivery models**, especially in East Asia. Chinese platforms have heavily subsidized services to capture market share, raising questions about sustainability, deflationary pressure, and longer-term risks of dominance by scale rather than efficiency (OECD, 2024).

Finally, the dominance of TNC platforms has reignited debate over the **consumer welfare standard** as the guiding principle of competition law. While traditionally measured through price, output, and consumer choice, digital markets raise broader issues—such as data privacy, algorithmic transparency, and innovation incentives—that require a more comprehensive analytical framework (Makridis A. & Tayer, 2024).

These developments illustrate that regulatory innovations are spreading globally. The EU’s **Digital Markets Act** and **Digital Services Act** have inspired similar reforms in Asia and Latin America, while international organizations such as UNCTAD and the OECD have highlighted the risks of concentrated digital markets, especially for developing economies with weaker enforcement capacity (OECD, 2024).

Taken together, these trends show how TNCs, particularly in e-commerce and social networking, have stretched the boundaries of traditional competition law. Their global reach, technological capabilities,

and platform-based business models require regulators to rethink domestic frameworks and reinforce international cooperation. This article thus examines the evolving relationship between TNCs and competition policy, highlighting the urgency of adaptive, cross-border strategies to safeguard fairness, innovation, and consumer welfare in the digital age.

### 3.1. Challenges of Regulating TNCs

Despite the proliferation of competition laws worldwide, regulating TNCs remains a formidable task. The complexity arises from the cross-border nature of their operations, the strategic use of regulatory loopholes, and the technological innovations that enable new forms of market dominance. Three major sets of challenges stand out are jurisdictional and enforcement problems as well as corporate strategies to circumvent oversight.

From jurisdictional and enforcement issues perspective, competition authorities are traditionally bounded by national jurisdiction. Yet, TNCs frequently engage in conduct that spans multiple markets, exploiting gaps in enforcement and inconsistencies between legal regimes. Cross-border mergers, global cartels, and unilateral practices such as self-preferencing or tying often affect consumers in multiple countries simultaneously. Enforcement fragmentation creates opportunities for “regulatory arbitrage,” whereby firms exploit differences in legal thresholds, procedural rules, and institutional capacities to minimize scrutiny (Bradford, 2020). The absence of a binding global competition authority means that remedies in one jurisdiction may be easily offset by continued practices in another.

On the other hand, TNCs actively design strategies to avoid or soften regulatory intervention. **Forum shopping** allows firms to incorporate subsidiaries in jurisdictions with more lenient merger thresholds or state aid controls, thereby shielding major structural changes from oversight. Global **tax planning** techniques, including the use of intellectual property havens and transfer pricing, not only reduce fiscal obligations but also create resource asymmetries that strengthen market dominance (Zucman et al., 2015).

Lobbying further complicates enforcement. Digital giants have become some of the most powerful lobbying actors in Washington, Brussels, and national capitals, influencing not only the design of competition law but also the prioritization of enforcement agendas (Fraser et al., 2025). Such activities blur the line between regulatory compliance and regulatory capture, undermining public confidence in the neutrality of enforcement.

The challenges of regulation are most vividly illustrated by the experiences of major digital platforms. **Google** has faced a series of European Commission investigations into search bias, Android exclusivity agreements, and advertising intermediation practices, resulting in multi-billion-euro fines (Akman, 2020). However, critics note that fines alone have limited deterrent impact without structural remedies, since Google's revenues dwarf the penalties imposed.

**Microsoft's** dominance in personal computing provides an earlier precedent. Its tying of Internet Explorer to the Windows operating system in the late 1990s led to landmark antitrust litigation in both the United States and the European Union. The case revealed the difficulty of crafting remedies that preserve innovation incentives while dismantling exclusionary strategies (Gavil & First, 2009).

**Amazon** raises distinct concerns in its dual role as both marketplace operator and retailer. Investigations in the EU and the U.S. have focused on its use of non-public seller data to advantage its own products, a practice that epitomizes the conflict of interest inherent in platform capitalism (Lianos, 2021).

Finally, **Apple's** control over its App Store illustrates the tension between innovation and exclusion. By imposing high commission fees and restricting alternative payment systems, Apple has faced legal action in both the U.S. (*Epic Games v. Apple*) and the EU, raising questions about the appropriate boundaries of vertical integration in digital ecosystems (Smizer, 2021).

### 3.2. Global Governance and International Cooperation: Resisting TNC Circumvention

The European Union (EU) has been at the forefront of designing regulatory tools to counteract the tactics by which TNCs evade competition law. Traditional **Ex-post enforcement**, where regulators intervene only after anti-competitive harm occurs, was deemed too slow and ineffective against digital gatekeepers whose dominance relies on entrenched network effects and data advantages. In response, the EU adopted the **Digital Markets Act (DMA)** in 2022, which imposes **ex-ante obligations** on firms designated as "gatekeepers." These obligations explicitly prohibit self-preferencing, bundling of services, and the use of non-public business data to compete with dependent firms, thereby directly preempting common circumvention practices (Ibáñez Colomo, 2021).

Moreover, the EU has innovated with the **Foreign Subsidies Regulation (2023)**, which closes another major loophole: reliance on foreign state

subsidies to distort internal market competition. With the WTO's subsidy control system largely paralyzed, TNCs with ties to state industrial policy—particularly in sectors like semiconductors, energy, and digital technology—previously exploited regulatory gaps by benefitting from opaque subsidies outside the EU's jurisdiction. The new regulation allows the European Commission to investigate and block acquisitions or public procurement bids by firms unfairly supported by third-country governments (Blockx & Mattiolo, 2023). This demonstrates how the EU uses its internal market power to extend regulatory sovereignty beyond its borders.

In the United States, resistance to circumvention strategies has centered on the revitalization of **antitrust enforcement**. For much of the 2000s, a permissive legal environment allowed digital giants to consolidate dominance through serial acquisitions, data-driven lock-in strategies, and exclusionary platform practices. The Biden administration marked a turning point, appointing progressive scholars such as Lina Khan to the Federal Trade Commission (FTC) and Tim Wu to the White House competition team. Under this leadership, the Department of Justice (DOJ) and the FTC, through broadening the analytical scope of U.S. antitrust beyond narrow consumer price effects, have launched landmark lawsuits against Google, Meta, and Amazon, targeting exclusionary contracts, monopolistic tying, and predatory platform practices (Portuese, 2022).

Developing economies face distinct challenges in resisting TNC circumvention. Weak institutional capacity, smaller budgets, and political pressure from foreign investors often limit the effectiveness of domestic enforcement. TNCs have historically exploited these vulnerabilities by shifting profits through tax havens, structuring mergers below notification thresholds, and engaging in aggressive lobbying in investment-dependent states. To resist these strategies, emerging economies have increasingly relied on **collective platforms** such as the **International Competition Network (ICN)**, the **OECD's Competition Committee**, and **UNCTAD's Intergovernmental Group of Experts on Competition Law and Policy**. These forums facilitate information sharing, capacity building, and soft convergence of standards, reducing the opportunities for TNCs to play jurisdictions against one another.

Some developing states have begun experimenting with **regional cooperation frameworks**. For example, the **Eurasian Economic Union (EAEU)** has adopted a supranational competition authority with powers to review cross-border mergers, while the **COMESA Competition Commission** in Africa plays a similar role for its member states. These

institutions, though still evolving, represent proactive resistance to TNCs' efforts to exploit fragmented national jurisdictions (Gal, 2009).

The cumulative effect of these measures is a slow but steady shift toward **hybrid governance**, where states blend domestic enforcement with international cooperation and regulatory extraterritoriality. TNCs may continue to test the boundaries of law through circumvention, but states are responding by reinforcing tools that operate across borders: subsidy control, merger review, mandatory data disclosure, and interoperability obligations. These strategies suggest that competition law is no longer confined to national economic policy, but is becoming part of the architecture of global economic governance.

#### 4. Regulated Conduct Doctrine and Competition Policy

Regulations such as state aid and subsidy regulations, foreign trade regulations, tax regulations, and financial oversight mechanisms constitute the primary economic tools used by governments to advance social welfare, the public good, and political objectives within the framework of the “public interest” theory. From an economic perspective, “public interest” theory envisages regulations to be implemented to ensure the public interest in response to “market failures”. In this case, it is anticipated that efficient allocation of resources cannot be achieved through the market mechanism, and it is thought that optimal distribution of the resources will be achieved through state intervention (Aktan & Yay, 2016a). However, these instruments frequently distort economic efficiency and undermine the competitive market mechanism, which are central pillars of economic theory. In such circumstances, competition authorities are compelled to navigate the tension between safeguarding the public interest and preserving economic efficiency—an issue that brings the Regulated Conduct Doctrine (RCD) into focus (Karakaya, 2022).

The Regulated Conduct Doctrine (RCD) serves as a guiding principle in resolving conflicts between the application of competition law and sectoral regulations. This doctrine helps determine which regulatory framework should take precedence when the obligations imposed by public authorities or regulatory bodies in certain sectors contradict the general prohibitive norms of competition law (OECD, 2011). The core rationale of the doctrine lies in the state's role in correcting market failures and promoting public interest through regulatory intervention. Accordingly, the RCD should not merely be regarded as a mechanism that legitimizes anti-competitive behavior, but

as a balance-oriented tool designed to preserve both economic efficiency and technological innovation within the framework of public welfare.

Striking this balance necessitates a cost–benefit assessment of regulatory interventions. The doctrine of regulated conduct is fundamentally based on the method of comparing the public interest with the requirements of competition law. Indeed, the benefits of sector-specific regulations are compared with the returns derived from the planned competitive mechanism in the market (Aktan & Yay, 2016b). This hypothetical comparison leads to a choice between maintaining market-specific regulations and establishing a competitive mechanism. In this case, when the benefits of sector-specific regulations outweigh their costs, the decision is made to maintain the relevant regulations, while when the costs are high, the decision is made to remove them (Trebilcock, 2005).

In the *Electricité de France (EDF)* decision, the European Commission determined that EDF, by virtue of its status as a public enterprise, was not subject to bankruptcy laws and had an unlimited state guarantee, which constituted incompatible state aid. The European Commission’s decision required the removal of the guarantee. Consequently, EDF was incorporated to be subject to market disciplines, thus eliminating the guarantee (Karakaya, 2022, p. 18).

One of the most pertinent decisions to the RCD is the Turkish Competition Authority’s (TCA) decision regarding TÜPRAŞ<sup>4</sup>. Indeed, in the case evaluated by the TCA, some private enterprises alleged that TÜPRAŞ failed to implement cost-effective pricing, engaged in excessive pricing, and thus abused its dominant position. During the file’s evaluation phase, the TCA determined that decisions by a sector-specific regulator on this matter would yield more effective results. The certainty provided by an “ex-ante” intervention by the sector regulator was preferred to an Ex-post intervention by the TCA (Sarıççek, 2012, p. 71).

The European Commission’s decision on the EDF determined that the economic efficiency derived from establishing a competitive mechanism was greater than that derived from sector-specific regulation. Therefore, the establishment of competitive rules was preferred. Nevertheless, in the context of TCA’s decision, it was preferred that sector-specific regulations would produce more effective results compared to competition regulations.

Closely related to the RCD is the notion of exemptions in competition law. Exemptions allow certain restrictive practices or agreements that would

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4 Decision of the TCA is dated 04.11.2009 and numbered 09-52/1246-315.

otherwise be deemed anti-competitive to be lawfully justified when they generate economic efficiency or social benefits. For instance, within the European Union, this concept has been institutionalized through Block Exemption Regulations. These regulations recognize that specific types of agreements—such as technology transfer, vertical distribution, or research and development (R&D) cooperation—may restrict competition to some extent but still contribute positively to overall economic efficiency and innovation (Esin, 2022). Therefore, the intersection between the RCD and the exemption principle plays a vital role in redefining the boundaries between state intervention and market competition, ensuring that public policy objectives are harmonized with competitive market dynamics.

Block exemption regulations can be viewed as legal instruments that promote technological efficiency and accelerate innovation processes. The European Commission's *Technology Transfer Block Exemption Regulation (TTBER)*, for instance, protects firms engaging in R&D collaborations or technology licensing agreements from the deterrent effects of antitrust enforcement (European Commission, 2025). This approach aligns with the public interest objective embedded in the RCD, framing technological progress as an integral component of social welfare. In the case of TTBER, the sharing of technological knowledge and the facilitation of innovation are not interpreted as anti-competitive conduct but as mechanisms that enhance market dynamism and long-term economic growth. Hence, block exemptions serve to legitimize technological advancement as a form of regulated conduct consistent with the pragmatic nature of the RCD (Brook, 2022).

Although the “exemption regime” is not applied in US competition law, the “rule of reason” analysis method is used instead through judicial precedent. With this analysis method, rather than creating a common exemption regime for all sectors as in EU competition law, the competition authority and courts conduct a case-by-case analysis for each case. The “rule of reason” analysis examines the competitive and anti-competitive effects of each action taken by the undertaking, and the net competitive effect is investigated by balancing these effects (through a cost-benefit analysis). During the analysis, it is examined whether there is an alternative action that is less restrictive of competition. Therefore, a benefit-cost analysis is performed for each case, and a decision is made accordingly. This demonstrates another exemption mechanism based on the RCD doctrine. Countries outside the EU generally apply an exemption regime (Turgut, 2021, p. 261).

In conclusion, the relationship between the RCD and block exemption regulations reflects the adaptability and contextual awareness of modern competition policy. Both frameworks recognize that market mechanisms do not always generate optimal outcomes. In sectors where technological development and innovation must be actively promoted, granting regulatory precedence over strict competition enforcement serves the broader public interest (Brook, 2022). The block exemption regime can therefore be interpreted as an institutionalized extension of the RCD. Together, these instruments establish a sustainable link between economic efficiency, technological progress, and competitive balance, demonstrating that modern competition law functions not only as a mechanism of market discipline but also as a strategic instrument of innovation and development policy. As observed in the analyses conducted, it is known that the RCD is the fundamental mechanism for balancing national interests and competition law, and that various regulatory mechanisms have been established within the framework of this doctrine.

## 5. Policy Recommendations

The analysis above highlights the profound challenges that transnational corporations pose for competition authorities worldwide. Addressing these challenges requires a multi-layered strategy that combines domestic institutional strengthening, international cooperation, and a careful balancing of national development objectives with global competition norms.

**First**, countries must strengthen their **domestic competition frameworks**. This entails not only modernizing legal provisions to cover digital platforms and algorithmic practices but also ensuring that competition authorities have adequate independence, resources, and technical expertise. Experience from the European Union and the United States demonstrates that robust institutions are prerequisites for resisting TNCs' circumvention strategies. For smaller or developing economies, capacity-building programs and the adoption of clear procedural rules—such as mandatory pre-merger notifications and data transparency obligations—can help close common regulatory loopholes. Competition policy is considered superior and takes precedence over sector-specific regulations in intervening in anti-competitive practices implemented by TNCs, prohibiting mergers and acquisitions that could distort competition, and facilitating the transition process for opening up regulated sectors to competition.

**Second**, there is a pressing need to enhance **international cooperation and information sharing**. TNCs operate across borders, exploiting

fragmented enforcement and regulatory arbitrage. Initiatives such as the International Competition Network (ICN), OECD roundtables, and regional institutions like the COMESA Competition Commission or the Eurasian Economic Union's competition body illustrate how coordinated review of mergers and cross-border conduct can prevent regulatory gaps. Strengthening these networks and embedding cooperation into bilateral trade and investment treaties would reduce the asymmetry between global firms and national regulators.

**Third**, policymakers must carefully **balance industrial policy with competition discipline**. While governments increasingly deploy subsidies and state aid to support strategic sectors—ranging from semiconductors to green technology—such measures must be designed with transparency and accountability to avoid distorting competition. Instruments such as the EU's Foreign Subsidies Regulation represent one way of reconciling industrial objectives with market fairness. For developing countries, the challenge is to ensure that industrial policy tools foster genuine capacity-building and innovation without entrenching monopolistic or protectionist structures. Supporting national champions, building the country's competitive strength, and ensuring the rapid and decisive development of infant industries and certain sectors can yield more effective results through subsidies and state aid. In this context, sector-specific regulations are considered more appropriate than competition regulations in terms of economic efficiency.

However, the disappointing performance of public monopolies, growing awareness of potential regulatory shortcomings, the weakness of arguments defending monopolies, and the effectiveness of technological developments in reducing costs and successfully transferring benefits to consumers create strong arguments in favor of competition law.

Within the framework of regulating multinational corporations and increasing the effectiveness of state aid and subsidies, markets expected to be competitive in the short term should be distinguished from markets requiring regulation in the long term. In the former case, implementing competition policy in regulating the relevant sector will yield positive market outcomes. In the latter case, implementing sector-specific regulations will play a significant role in increasing economic efficiency.

## 6. Conclusion

The historical trajectory of competition law reveals a continuous negotiation between ethical ideals, political authority, and economic analysis. Ancient Mesopotamian and Roman rules reflected a sovereign duty

to stabilize essential markets, while Greek and scholastic thought grounded exchange in justice and fairness. Asian and Islamic contributions emphasized the integration of moral duty with institutional oversight, shaping norms that still resonate in modern consumer protection and anti-cartel enforcement.

Early-modern struggles over royal monopolies reframed competition as a constitutional issue—shifting from privilege to parliament and law. The American antitrust tradition institutionalized this spirit, evolving from structural preservation of rivalry toward an economics-based analysis. By contrast, the European Union embedded competition policy within integration, ordoliberal fairness, and administrative control, offering a distinctive model that balances economics with broader social concerns.

Economists of the 18th to 20th centuries profoundly influenced enforcement. Smith highlighted both the virtues of rivalry and the dangers of collusion; Mill stressed welfare limits; Schumpeter and Hayek reframed competition as innovation and discovery; Solow quantified growth drivers. These insights, later refined by Chicago and post-Chicago scholarship, forged the analytical tools still used in courts and agencies today.

The enduring lesson is that competition law is never static. It adapts to technological change, economic theory, and political values. In the digital era of platforms, data, and algorithms, the discipline must again recalibrate—preserving rivalry, encouraging innovation, and preventing exclusion while recognizing its dual heritage: a moral commitment to fairness and a pragmatic reliance on economic science.

The growing influence of transnational corporations, particularly in the digital economy, has tested the resilience of traditional competition law frameworks. Platforms that simultaneously function as marketplaces, advertisers, and sellers embody new forms of market power that cannot be adequately addressed by narrow consumer welfare metrics or purely national enforcement strategies. The EU's proactive regulation, the revitalization of U.S. antitrust, and the cooperative efforts of developing economies illustrate an emerging pattern: countries are resisting corporate circumvention not in isolation, but through coordinated, hybrid governance.

This article has shown that the challenges are multidimensional—jurisdictional fragmentation, sophisticated corporate avoidance strategies, and the technological complexity of algorithmic and data-driven markets. Yet it has also demonstrated that states are not powerless. By strengthening domestic institutions, expanding international cooperation, and carefully

integrating industrial policy with competition norms, governments can reassert control over markets dominated by TNCs.

Ultimately, the regulation of TNCs is not merely a technical legal issue but a cornerstone of global economic governance. Ensuring that markets remain fair, contestable, and innovative requires **adaptive, cross-border competition policies** that reflect the realities of an interconnected global economy. Without such adaptation, the risks of concentration, inequality, and diminished consumer welfare will only deepen. With it, competition policy can continue to serve as a guardian of both economic efficiency and democratic accountability in the era of transnational corporate power.

Although competition policy is dynamic, striking a balance between national interests and competition policy remains a difficult choice for policymakers. In this context, it should be noted that all discussions are shaped within the framework of the “Regulated Conduct Doctrine.” Indeed, it is impossible to reach a definitive conclusion as to whether sector-specific regulations or competition policy will be more effective economically. Which regulation will provide greater efficiency depends on time, place, and the economic methods applied. In this context, the use of more measurable economic indicators in the implementation of economic regulations (including competition regulations) will shed more light on this debate.

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## From Liberal Orthodoxy to Illiberal Democracy: Hungary's Turn Toward Financial Nationalism

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### Abstract

As an element of economic policy, economic nationalism is defined today as a view that defends national economic interests against globalization and neoliberal policies across a wide range of areas, from the control of capital movements to monetary policies. Financial markets have also started to witness nationalist-themed practices, particularly after the 2008 global financial crisis. In this context, we frequently observe practices like localization in the banking system and nationalization in strategic sectors. In this study, the practices of economic and financial nationalism in Hungary, which has been governed by the nationalist Orban since 2010, have been historically evaluated.

### 1. Introduction

Due to the market's role in organizing society and economic activities, the political economy has been divided into three ideological structures for over a century: socialism, liberalism, and nationalism. These three ideologies differ in their answers to these questions: Roles of markets in organizing the society, production and growth, distribution of income and wealth (Gilpin, 1987: 25). Although numerous discussions were held in academia both pre-World War I and during the interwar period, economic nationalism did not come to the forefront as much as other movements, especially due to the bipolar world after World War II (Levi-Faur, 1997: 359).

Historically, economic nationalism has advocated for the primacy of politics over economics in the early modern period. In this respect, it is a doctrine of state-building and argues that the market should operate in accordance with the interests of the state. In other words, for the early

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modern period, economic nationalism means that economic relations should be determined by political factors. In this respect, economic nationalism during that period is also known as mercantilism. Liberalism, one of the three fundamental ideological structures mentioned above, emerged in opposition to this idea and advocated for the separation of economic activities and politics during the Enlightenment. Finally, Marxism emerged as a counterpoint to liberalism, arguing that the economy should guide politics in the 19th century (Gilpin, 1987: 26).

In the early 1900s, economic nationalism was associated with protectionist trade policies and accumulation of gold. During the 20s and early 30s, it also included a wide range of economic policy tools, such as taking over foreign companies, controlling capital flows, and setting monetary policies (Hesse, 2021: 15). Economic nationalism began to gain attention in the 1980s and 1990s, particularly in parallel with the rise of neoliberal policies. Especially in the world before the 2008 crisis, countries' desire for more free trade and independent economic policy implementation came to the forefront. However, following 2008, more emphasis began to be placed on the traditional meaning of the term economic nationalism, particularly in the United States and China (especially in terms of protectionist policies). This emphasis has been recognized in academic literature as "neo-mercantilist" policy sets (Helleiner, 2021: 230).

The modern political approach to economic nationalism is regarded as an economic theory and policy set approach that opposes economic liberalism and globalization. Although it has an ideological context, economic nationalism is at the intersection of economics, politics, and culture. This situation leads to very different interpretations. Therefore, there is no agreed-upon clear theory about it. It can be said that economic nationalism is a phenomenon that seeks answers to issues such as national economic performance, regional integration, transformation activities and outcomes, and social integration (Pickel, 2003: 116-118).

Governments explore alternative solutions to address the macroeconomic performance problems mentioned above. Financial markets also face these issues, particularly in the unstable post-2008 financial crisis environment. Financial nationalism with an illiberal orientation has surfaced as a notably attractive strategy for numerous governments. Especially after World War II, the increasingly globalized world trade and financial markets have led to capital movements and financial markets taking on a transnational form (Johnson and Barnes, 2025: 260). From 1975 to 2014, there was a steady rise in international standards and rules for almost every part of making

financial policy, from anti-money laundering applications to banking supervision, derivative markets, efforts to promote financial inclusion, and even cryptocurrencies. At this point, the focus of economic nationalism studies lies on trade barriers and policies. But there is little attention to nationalism in finance (Lupo-Pasini, 2019: 94-95).

The primary aim of this study is to investigate financial nationalism as a specific policy area of economic nationalism. This investigation provides an opportunity to understand how economic nationalism demonstrates itself in finance markets, banking system ownership, foreign investments and state's roles. The study also aims to identify the reasons behind the rise of the economic and financial nationalism phenomenon through the Hungary case study.

The main reason for selecting Hungary as a case study in this research is that the country has demonstrated a management model that systematically implements economic and financial nationalism policies since 2010. The government's rhetoric prioritizes national sovereignty under the leadership of Viktor Orbán. Its cautious stance toward foreign capital and its policies promoting domestic production provide a rich ground for observing the contemporary reflections of economic nationalism.

Furthermore, despite being a member of the European Union, Hungary occasionally adopts a critical and independent stance toward economic integration processes, highlighting the tension between the global economic order and national interests. In this respect, Hungary serves as a striking example of how economic nationalism may emerge not only in developing countries but also in developed and integrated ones.

The study consists of four main sections. First, the foundations of the concept of financial nationalism and nationalist approaches to financial policies and practices will be discussed. In this section, reasons for the rise of nationalism in financial and economic politics will be discussed. The following section will summarize nationalist financial approaches of Hungary. Following this section, the changes in Hungary's macroeconomic and governance data during the period of intensified nationalist policies will be briefly examined. The chapter will end with a general conclusion.

## **2. The Nationalist Perspective of Finance**

Financial nationalism refers to the policies, regulations, and administrative measures that governments and regulatory agencies enact to preserve sovereignty over their national financial and monetary systems. Financial nationalism includes mechanisms from capital flow restrictions

to requirements for the domestic operation of foreign financial technology firms, aiming to shield national financial and monetary systems from external political or economic pressures—such as influence from multinational entities or international financial institutions (Lupo-Pasini, 2019: 102).

According to Johnson and Barnes (2025), modern financial nationalism embodies three perspectives, which are nationalist in its impetus for political engagement, financial in its policy orientation, and illiberal in political economy. The nationalist perspective believes that the people of a country should wield political control over its territory. As a natural consequence of this, economic nationalists support the use of economic institutions and policies to promote national unity, being primary beneficiaries of government policies and forward their nationalist agenda. Secondly, this approach uses financial systems, institutions, and laws for national purposes. Financial nationalism involves controlling the banking system, monetary and fiscal policy tools, financial regulations, and international institutions to achieve goals. Lastly, financial nationalism's roots are self-consciously illiberal policies. Financial nationalism in the modern period is a manifestation of support for the nation and being against the global liberal system (Johnson and Barnes, 2025: 261-264).

In the world that celebrated financial liberalization after 1970, international capital mobility increased. In cases where states moved away from market liberalism after 1990, international firms or institutions used capital flows or debt as a stick to force these countries to remain within the system. Consequently, governments have come to determine their domestic policies in order to remain within the international financial system. However, the 2008 crisis was a turning point in this regard. In the period following the crisis, many economic administrations made attempts to re-establish state autonomy. Financial nationalism, despite the structural strength of the financial sector, has enabled increased state autonomy. The first applications in this regard were particularly evident in regulations related to the nationalization of the banking sector. Financial nationalist leaders have argued that changes in ownership (nationalization) within the banking sector are a fundamental requirement for financial stability and economic development (Piroska, 2021: 5-7).

According to Piroska (2021), studies on financial nationalism are primarily examined in international finance literature in relation to three theories. These theories encompass the structural power of finance, the financialization of the state, and the financialization of daily life. In this study, following the methodology of Piroska (2021), financial nationalism will

be evaluated through an examination of practices in Hungary, focusing on changes in bank ownership structures in favor of local powers, modifications in monetary policy, and measures aimed at protecting households from externally sourced financial shocks.

### 3. The Case Study of Financial Nationalism: Hungary

Nationalism of economics or finance exhibits a variety of political orientations and economic emphases. Thus, exploring the nature of nationalism differs by region, institutions, or subtype of application. This section will discuss the economic and financial nationalism practices implemented in Hungary.

In contemporary Hungarian history, the 20th century witnessed critical developments. The most important turning points in Hungary's in this century were the collapse of the empire after World War I, the shift to the communist regime that followed World War II, and the fall of that regime after 1990. Following the collapse of the communist system, the country attempted to adapt to the liberal Western system. But because of various economic difficulties, nationalist movements within the country have had a significant impact, particularly after 2010. Thus, the country's transformation in the new century is taking place through illiberal democracy.

Especially from the 1960s until the collapse of the system, the communist regime was able to make Hungary one of the most tolerant and economically successful countries in the Eastern Bloc. This situation ensured that regime change, unlike in some other Eastern Bloc countries, occurred not through conflict between society and the state, but through mutual negotiations between the opposition and regime administrators. For almost two decades following 1990, the country implemented various reforms to align with the fundamental institutions of Western democracy and the capitalist world, clarifying its place in the new order by becoming a member of both the European Union and NATO (Greskovits and Wittenberg, 2016: 3).

Hungary regarded EU membership to reclaim its role in European politics and economy after communist rule. The 1994 election winner, the Hungarian Socialist Party, adopted austerity in 1995 and signed an IMF standby agreement in 1996. Capital controls were eased, European Union financial regulations were enacted, and foreign ownership was allowed in banks as part of these attempts to integrate with the western economy. Foreign currency loans increased significantly when the government announced its desire to join the Eurozone. At the start of the 2000s, foreign institutions demanded tightening regulations from Hungary due to its

enormous public debt. After winning the 2006 election, the Socialist party adopted tough austerity measures while campaigning to the contrary. Despite these procedures, Hungary was significantly impacted by the 2008 financial crisis. Thus, the IMF, EU, and World Bank had to lend money for stricter restrictions. These outcomes demonstrated that Hungary's economy was highly susceptible due to its financial and economic openness. In addition to 1970s-era economic policies, the 2008 crisis strengthened nationalist parties led by Viktor Orbán in Hungary and promoted financial nationalism (Johnson and Barnes, 2015: 541-543).

Under the leadership of Viktor Orbán, the right-wing populist party, Fidesz, has participated in all elections since 1990. In the 1990-1994 and 1998 elections, Fidesz received 8.95%, 7.01%, and 29.48%, respectively. From 2002 onwards, Fidesz rapidly increased its vote and never fell below 40% again. Fidesz's and Viktor Orbán's first major election success also took place during this period. In the 2010 elections, they came to power for the second time but for the first time by receiving more than half of the votes (52.73%) and reached the supermajority needed for constitutional changes (parliament.hu, 04.08.2025). This date marked the beginning of the transformation in terms of economic policies to be implemented in Hungary. This transformation can be understood through two key concepts: illiberal democracy and financial nationalism.

For over a century, especially in the Western world, liberalism has been defined as a political system where democracy exists, free and fair elections can be held, and fundamental rights and freedoms are protected by the constitution. However, today there is a divergence between democracy and constitutional rights. It has been observed that parties (or leaders) who seize power following democratic elections in different geographies are subsequently able to partially or completely suspend constitutional rights. This structure is known as illiberal democracy (Zakaria, 1997: 22-23).

Orbán, considering the country's historical experiences in the interwar period, used Hungarian nationalist historical trends as the foundation for current government policies. The traumas caused by the Treaty of Trianon signed at the end of World War I and the 1944 German occupation were important milestones in shaping Orbán's xenophobia, which has been a factor in recent economic and political instability. In this process, Orbán isolated himself from other right-wing parties and, through his actions, showed himself as the sole representative of the Hungarian people, thus surpassing his political rivals (Toomey, 2018: 101-103). One of the first actions of the Orbán government was to make some updates to the existing constitution

and pass a completely new constitution through parliament the following year. The new constitution contained articles that would allow Orbán's government to consolidate its power by eliminating constitutional balance mechanisms. In the new system, he had regulations passed in parliament that would allow him to maintain control over both the media and national and international non-governmental organizations (Kelemen, 2017: 221-222). The establishment of The National Media and Infocommunications Authority - NMHH and Central European Press and Media Foundation, and the adoption of Transparency of Organizations Receiving Support from Abroad Law show the government's efforts to strengthen its power over the media and international institutions (NMHH, 2010; Patricolo, 2018; Venice Commission, 2017).

Orbán's speech on July 26, 2014, lays out the ideological foundation for Hungary's transition to illiberal democracy. In this speech, he argued that liberal democracy could not protect Hungarian national interests against individualism, market primacy, and global capital. In this context, he states that the new state built in Hungary has a democratic but not liberal structure. Orbán describes the effects of the 2008 global financial crisis as being as transformative as the major wars and regime changes of the 20th century. In his speech, he emphasized the importance of trying to understand how systems that are non-Western, non-liberal, not liberal democracies, and perhaps not democracies at all can still make their nations successful in the years following the crisis. According to Orbán, the illiberal democratic structure is the only way to protect national interests in global competition in the long run (Orbán, 2014a).

The new system created by Orbán has two important economic aspects for regain policymaking autonomy power: to free itself from the pressure of international financial capital and institutions and to transform the domestic financial system to allow for the restructuring of the country's economic system, thereby creating new sources of financing. When these practices are considered from a financial perspective, they are interpreted as Hungary departing from orthodox-neoliberal policies. The government is now pursuing a set of policies known as financial nationalism (Sebök and Simons, 2022: 1628-1629). According to Orbán, which his speech mentioned above, the liberal state has failed to protect society from debt slavery, defend national resources, and serve the interests of the powerful. Orbán's speech offers an alternative based on national sovereignty, economic independence, and cultural solidarity in response to the crisis of liberal democracy observed since 2008 (Orbán, 2014a). In this context, The Orbán government wrote a letter to the IMF in 2013 as part of its financial nationalism policy

implementation. The Orbán government demanded the early repayment of a 2008 loan debt and the closure of the IMF office in the country (Reuters, 2013). Additionally, the Central Bank of Hungary established a Self-Financing Program in 2014. The primary objective of the program was to mitigate the external vulnerability of the country's economy. Consequently, the Central Bank modified its monetary policy tools to motivate banks to allocate excess liquidity into liquid securities, which, due to the specificities of the Hungarian environment, primarily entailed a surge in the demand for government bonds (Hoffmann and Kolozsi, 2016: 5).

In his state of the nation address in February 2014, just before his second consecutive election victory in April 2014, Orbán summarized the activities carried out over the past four years, effectively providing an overview of the implementation of economic nationalist policies. In this speech, Orbán clearly stated that they began to change the system in 2010, which had been previously attempted to be repaired but failed. He also stated that a policy based on pleasing foreign capital, the foreign press, and other Western institutions was no longer applicable (Orbán, 2014b). In the period after 2010, despite rejecting the euro and opposing European Union origin advice, the Orbán government did not put leaving the EU on the agenda. They see EU membership as a prerequisite for being an equal European nation. However, on the other hand, policies have been implemented in Hungary to reduce the influence of foreign-owned banks and foreign currencies and to increase Hungary's monetary sovereignty and privilege. At this point, in order to gain political control over monetary policy, the MNB was weakened and relations with the IMF were gradually reduced, implementing policies that are understandable from a financial nationalist perspective (Johnson and Barnes, 2015: 545).

After coming to power in 2010, the Orbán government waited until 2013 to make the most fundamental change in its monetary policy. On this date, György Matolcsy, who was the Minister of Economy in the government at the time, was appointed as governor. Previous governors' careers included positions with a strong connection to international markets, such as stock exchange presidency and retail banking. The Orbán government, as part of its financial nationalism and authoritarian capitalism practices, has appointed a new name to redesign the bank's operational mission. The first and most important task of the Matolcsy era was to support the domestic banking sector and nationalize large banks. This way, the aim was to reduce the share of foreign capital in the banking sector to less than 50%, and work in this direction continued. In addition, supporting the government's economic policies, alongside the central bank's price stability and financial

stability goals, has increasingly become the most important element among the central bank's core authorities. Therefore, the central bank prioritized adjusting its monetary policies based on the national context rather than the international ones (Sebk et al, 2021: 9-16).

The Orbán government also pursued a nationalist approach to fiscal policy to mitigate the devastating effects of the 2008 crisis. The three main sectors with the highest foreign capital in the country (retail, telecommunications, and energy) have implemented crisis taxes. Again, during that period, the taxes it brought to the banking sector, which was largely controlled by foreign capital, increased the sector's tax burden by more than three times. Banks were forced to convert mortgage loans denominated in foreign currency into local currency due to the negative effects of the local currency's depreciation during the global crisis. In addition to these, the second-tier private pension fund was also nationalized. As a result of these measures, the foreign ownership rate in the banking sector decreased from 80% to under 50% by the end of 2017. The government carried out a very broad nationalization activity, encompassing small airline companies, public transport companies, and the manufacturing industry, in addition to the aforementioned sectors with a significant foreign capital presence (Toplišček, 2019: 393). Joint infrastructure projects were also signed with Russia and China in the energy and transportation sectors to reduce dependence on the EU and the Western world (Condon, 2024).

The history of Hungary over the past 35 years can be briefly summarized as below: Hungary was considered the shining model of the post-1989 era among former Eastern Bloc countries. Among the transition economies, Hungary was the first to rewrite its constitution emphasizing democratic values, respect for the rule of law and human rights, maintain a steady string of free and fair elections, and attract significant foreign direct investments. EU membership in 2004 and the 2008 financial crisis led to significant changes in the country's destiny. In less than a decade after joining the EU, Hungary has become a model "illiberal state," with constitutional checks and balances failing, foreign investment declining, judiciary and media independence questioned, civil society groups under attack and political prosecutions (Scheppele, 2016: xv-xvi). It is also observed that, especially after 2010, companies and businessmen close to the government are frequently preferred in public tenders and the transition of expropriated companies back to the private sector. Toth and Hajdu (2018) examined 126,330 public procurement contracts from 2010 to 2016 and found that businessmen close to the government, such as Lőrincz Mészáros, István Garancsi, István Tiborcz, and Lajos Simicska, had significantly higher corruption risks and

lower competition intensity compared to ordinary Hungarian companies, giving them an advantage in winning public procurement contracts. This situation can be interpreted as the operation of a system of cronyism in public procurement and a kleptocratic state in Hungary.

In this subsection of the study, the nationalism policies implemented by the Orbán government in Hungary within the economic and political agenda are explained. Table 1 outlines and historically summarizes the government's activities under its nationalism policies, following its first major election victory in 2010.

#### **4. The Economic and Governance Implications of Nationalist Practices**

In this subsection, the evolution of the Hungarian economy in the 21st century will be summarized. This period can be divided into two subgroups: the period before 2010, when neoliberal policies were widely implemented, and the period after 2010, when the influence of nationalist policies strengthened. All data used in this subsection was obtained from the World Bank dataset.

The compound annual growth rate (CAGR) of GDP (constant 2015 US\$) is 1.9% for the first period and 2.3% for the second period. Similarly, the annual compound growth rate of GDP per capita (PPP, constant 2021 international \$) was calculated to be 2.1% and 2.6%, respectively. This situation indicates that the income level gained a higher rate of increase during the 14-year period under the Orbán government. However, this enrichment has not been felt equally across society. The Gini coefficient, which measures income inequality, averaged 28.8 for the first period (minimum 26.8 and maximum 34.7) and 30.2 for the second period (minimum 29.2 and maximum 31.5). Similarly, the average share of total income received by the top 20% of society has increased from 37.6% to 38.3%, while the share received by the bottom 20% has decreased from 8.7% to 8%.

Regarding consumer price inflation, the outlook appeared more positive in the second sub-period. Despite high inflation in 2022 and 2023 (14.6% and 17.1%, respectively), the average annual inflation increase during the Orbán period was 4.6%, compared to 6% before 2010.

According to ILO models, there is also a noticeable decline in the country's unemployment rate during the Orbán era. While the average unemployment rate was 7.3% in the first period, it decreased to 6% in the subsequent period. Especially after 2013, a sharp decline in the unemployment rate was observed, from 10% levels to 4% levels.

In the pre-2010 period, when neoliberal economic policies were intensively implemented, the country consistently ran a current account deficit. In contrast, except for the period from 2019 to 2022, there was generally a current account surplus during the Orbán era. The current account balance as a percentage of the country's GDP averaged -6.5% before 2010, while under Orbán, this ratio averaged +0.2%.

The generally positive sentiment observed in economic data occurred despite the country's negative trend in the governance index. In Hungary, which was one of the most successful countries in terms of democratization during the 1990s, governance indicators have steadily worsened. Hungary has declined from its highest score of 0.94 in 2007 on the Rule of Law Index to a level of 0.42 during the Orbán era. The Transparency and Accountability Index data shows that the highest level was 1.18 in 2005, but it rapidly declined to 0.35 after 2010. Similarly to these two indicators, the country also performed poorly in the corruption index. The control of corruption decreased from an average of 0.55 between 2000 and 2010 to 0.10 between 2010 and 2023. In fact, it showed negative values in 2022 and 2023.

Since the Orbán government came to power in 2010, it has taken successful steps to improve the country's negative economic outlook, particularly that stemming from the 2008 financial crisis. Especially in macroeconomic data, a general atmosphere of improvement has prevailed over the past 14 years. However, for the Hungarian people, this improvement has been a result of the country's deteriorating governance.

## 5. Conclusion

The political economy is categorized under three ideological frameworks: socialism, liberalism, and nationalism. Although its roots extend back to the early modern period and it is known as mercantilism, unlike socialism and liberalism, economic nationalism did not come to the forefront after World War II until the 1980s' globalized neoliberal world. After the 2008 financial crisis, nationalist views expanded to the financial markets as well as economic politics.

Financial liberalism has economic, financial, and even political implications in both domestic and international contexts. These methods range from building a national financial system to interacting with international financial institutions and multinational companies, as well as from legal pressures to nationalizations and company acquisitions. Because of its complex structure, a clear definition of financial nationalism cannot be made. However, this

concept can be defined as a set of practices that prioritize the country's and nation's interests against the global and liberal system.

In this section, Hungary is chosen as a case study to discuss how economic and financial nationalism presents itself in financial markets and strengthens the state's role within the market. The fact that nationalist groups, who have been strongly in power since 2010 under the leadership of Viktor Orbán, are systematically implementing economic nationalist policies despite EU membership makes this country an important case study on this issue.

The 20th century has many different political eras for Hungary. Most of the century that began with the kingdom was spent under a socialist regime, and the last 10 years were spent trying to integrate into the institutions of the liberal Western world.

As a nationalist leader, Viktor Orbán has consistently been on the political scene since the post-socialist era. The 2010 elections were a victory year for Orbán and Fidesz, the union for right-wing parties, as they won a constitutional amendment majority. Orbán, who has been in power since then, has made changing the constitution a priority. In the following years, the central bank played a key role in strengthening the country's financial system to benefit its citizens. The easing of the debt burden of households and the public, especially in foreign currency, from previous years; the nationalization of the financial system, particularly the banking system in the country; the request to close the IMF office in the country after the payment of IMF debts; and the increase in the weight of the public and local entrepreneurs in various strategic sectors, especially infrastructure, are a reflection of the economic and financial nationalism policies implemented in the country. However, the media law passed during this process, as well as legal regulations such as the transparency law for foreign-funded civil society organizations, was the result of the illiberal democracy expression that Orbán began to emphasize in 2014.

Orbán's policies implemented in Hungary after 2010 have had both internal and external effects in both economic and political dimensions. However, in his speeches, Orbán has stated that his priority is the interests of the Hungarian nation, thus disregarding external criticisms. However, while doing this, he did not isolate the country from the whole world or adopt a completely hostile attitude toward foreign capital. Orbán views public dominance in strategic sectors, particularly banking, as a guarantee for the country's future.

This study's primary limitation is its examination of the issue of economic and financial nationalism solely in the context of Hungary. The concept and practices of economic nationalism have different effects in developed and developing economies. These effects have the potential to impact both national and international arenas. The economic war between the US and China over tariffs has the potential to impact the world. In addition to this, these practices are also seen in other former Eastern Bloc countries, such as Romania, Poland, and the Czech Republic. While these countries were changing their institutional structures to integrate into the liberal world economy after 1990, the events of the 2008 financial crisis and its aftermath led to a review of economic and financial policies in these countries as well. For these reasons, it is hoped that this study, prepared for the example of Hungary, will also contribute to new studies being conducted in other countries.

**Table 1. Important Political and Economic Events During Orbán-Era**

| Year | Event                                                                                                                                                                                                        |
|------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 2010 | Fidesz's and Viktor Orbán's election success ( <i>supermajority for constitutional changes</i> )                                                                                                             |
| 2010 | The National Media and Infocommunications Authority - NMHH was established ( <i>which is controlled by government</i> )                                                                                      |
| 2011 | The new constitution came into force                                                                                                                                                                         |
| 2012 | New election law came into force ( <i>including regulations in favor of the ruling party</i> )                                                                                                               |
| 2013 | The acquisition of German E.ON's gas distribution and storage assets in Hungary by the state-owned MVM ( <i>as the beginning of nationalization in the energy sector</i> )                                   |
| 2013 | György Matolcsy appointed as central bank governor                                                                                                                                                           |
| 2013 | Central Bank Act renewed                                                                                                                                                                                     |
| 2013 | Acquisition of stakes of Széchenyi Bank and Granit Bank ( <i>as the beginning of increasing weight of state ownership in the banking industry</i> )                                                          |
| 2013 | IMF office in the country closed                                                                                                                                                                             |
| 2014 | The concept of illiberal democracy began to be emphasized in Orbán's speeches                                                                                                                                |
| 2014 | Implementation of the Self-Financing Program ( <i>for reducing external vulnerabilities of government debt</i> )                                                                                             |
| 2014 | Budapest Bank bought from GE Capital ( <i>8th biggest lender of the country</i> )                                                                                                                            |
| 2014 | MKB bought from Bayerische Landesbank Germany ( <i>5th largest commercial bank</i> )                                                                                                                         |
| 2017 | Transparency of Organizations Receiving Support from Abroad Law has been passed ( <i>withdrawn in 2020 due to EU pressure</i> )                                                                              |
| 2018 | Central European Press and Media Foundation was established ( <i>supported by the government for national values, and the management of more than 500 media outlets was transferred to this foundation</i> ) |
| 2020 | Budapest Bank, MKB and saving group Takarekbank announced a strategic alliance to form 2nd largest banking group                                                                                             |
| 2024 | Cooperation with Russia and China has begun to be strengthened to reduce dependence on the EU in infrastructure projects ( <i>Railway project and Nuclear Power Plant project</i> ).                         |

*Source: Prepared by the author's own efforts. The sources used are listed in the references.*

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## Economic Nationalism and Agricultural Policies: A Panel Data Analysis of the Impact of Trade openness on Agricultural Structures in Selected Countries

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### Abstract

This study analyses the relationship between economic nationalism and agricultural policies within a historical, theoretical and empirical framework. A comparative analysis of India, Turkey, Russia, Brazil, Egypt and China reveals nationalist aspects of agricultural policies focusing on domestic production and food security. Using panel data from 1990 to 2024, the empirical analysis reveals that openness to trade reduces the agricultural share of Gross Domestic Product (GDP); however, this effect varies across countries. The findings suggest that economic nationalism is a resurgent trend in agriculture.

### 1. Introduction

Economic nationalism is defined as the set of strategic measures adopted by nations to establish, strengthen and protect their domestic economies within the context of the global market. In our era of widespread global integration, economic nationalism seeks to influence economic decisions in accordance with national interests via a state-centred approach.

Pryke (2016) defines it as ‘policies aimed at building, supporting and protecting national economies’; these often include tools such as trade

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protectionism, restrictions on foreign direct investment, immigration control and avoidance of multinational agreements. Classifying this approach into six key policy areas demonstrates that economic nationalism can be understood as practice-based rather than ideological.

While economic nationalism is generally evaluated theoretically through policy tools such as tariffs, investment restrictions and domestic production incentives, a motivation-focused definition has recently emerged in the literature. This approach focuses on whether a policy prioritises national interests, i.e. whether it has a national goal, rather than its formal content (Pryke, 2016).

A subsidy or tariff measure is evaluated not only as an intervention tool, but also based on its implementation purpose. If the primary objective is to protect domestic firms in international competition, build strategic independence or increase economic autonomy, these policies are classified as economic nationalist policies (Helleiner, 2002; Pryke, 2016). Clift and Woll (2012) further expand on this, stating that free market-oriented policies, as well as protectionist measures, can be considered part of economic nationalism if implemented with the aim of 'serving the national interest'. This is particularly evident in practices shaped around the concept of 'economic patriotism'.

In line with this approach, the motive-based approach argues that economic nationalism should be evaluated based on its purpose rather than its form. This suggests that both protectionist and selective liberalisation policies can be categorised as economic nationalism when they are designed with national motives.

The concept of economic nationalism was theoretically developed and put into practice alongside nation-state building processes in the 19th century. One of the most notable contributions to this historical development was made by the German political economist Friedrich List. In his work *The National System of Political Economy* (List, 1841), List argued that free trade only benefited developed countries, and that industrialised countries should implement temporary protectionist policies to protect their infant industries.

By the 20<sup>th</sup> century, and particularly following the Great Depression of 1929, many countries, notably the United States, adopted economic nationalist policies involving import restrictions, public investment and tariffs (Helleiner, 2002). Following World War II, in line with Keynesian

ideas about state intervention, industrial policies, development planning and import substitution approaches were institutionalised (Block, 2003).

However, in the historical cycle of economic nationalism, the influence of these approaches declined with the rise of neoliberal globalisation discourse in the 1980s. Nevertheless, after the 2008 global financial crisis, the role of the state in the economy was brought back onto the agenda, and the protection of strategic sectors, reduction of import dependency and discourse of 'economic sovereignty' were revived within the framework of economic nationalism (Pryke, 2016; Helleiner, 2021).

Economic nationalism intersects with mercantilist thinking, placing national interest at the centre of economic planning. It has made a strong comeback in the 21st century, particularly as issues such as inequality and external dependency caused by globalisation have been revisited. This resurgence is characterised by the concepts of 'neo-mercantilism' or 'new protectionism' (Evenett & Fritz, 2019; Hopewell, 2017).

The most visible example of this resurgence was the policy agenda of former US President Donald Trump between 2017 and 2020. During his presidency, additional tariffs were imposed on China, NAFTA was revised into USMCA, and strategic nationalism was implemented in foreign trade under the 'America First' doctrine (Bown & Kolb, 2021; Farrell & Newman, 2019). These policies demonstrate a shift away from classical liberal trade rules towards protecting national production, security and labour markets.

The Trump administration's actions have been interpreted as both populist rhetoric and a strategic repositioning aimed at preserving US economic hegemony (Helleiner, 2021). The 25% and 10% tariffs imposed on the steel and aluminium sectors have been explained in both economic and geopolitical terms (Bown, 2018). This situation has revealed that trade is not solely based on efficiency and mutual gain, but is also shaped by power relations.

Indeed, in light of these developments, economic nationalism has become an increasingly prevalent policy among both developed and developing countries. The first quarter of the 21<sup>st</sup> century is regarded as a new form of mercantilism, in which the liberal trade system has been restricted, supply chains have been reorganised on a 'domestic' basis, and economic autonomy has emerged (Tooze, 2021).

Although the Joe Biden administration has adopted a more open and multilateral approach, many of the economic nationalist policies established during the Trump era have been preserved and even institutionalised. This

situation has been defined as ‘strategic economic nationalism pursued within liberal rhetoric’ (Chin & Nolan, 2022).

Notably, the CHIPS and Science Act of 2022 directly supports semiconductor manufacturing, clean energy, and advanced technology sectors with federal subsidies, imposing conditions such as ‘domestic production’ and ‘job creation in the US’ on investments in these areas (White House, 2022). The Inflation Reduction Act (IRA), which came into effect in the same year, not only promotes environmentally friendly transformation, but also aims to encourage domestic green industrialisation (Pisani-Ferry et al., 2023). These regulations aim to increase the strategic autonomy of the US in the most critical areas of global competition.

As part of this, the Biden administration has started to promote ‘friend-shoring’ and ‘near-shoring’ policies with its allies. These policies are not protectionist, but rather seek to maintain geopolitical balances against China (Rodrik, 2023). This type of economic nationalism envisages restructuring supply chains within political boundaries rather than practising direct mercantilist protectionism.

These measures aim to protect the domestic market and secure strategic technological superiority and long-term economic hegemony against rival powers such as China. Therefore, Biden-era policies constitute a new form of economic nationalism that is more aligned with the tradition of ‘state-guided industrial policies’ than with classical liberalism (Zhao, 2023a).

These developments are not limited to the United States. In response to US subsidies for the green industry, the European Union introduced the Net-Zero Industry Act and the Critical Raw Materials Act in 2023. These regulations combine green transformation policies with strategic industrial incentives and aim to reduce external dependency (Zachmann et al., 2023; Meunier & Nicolaidis, 2019). This reflects a new mercantilist orientation that deviates from traditional free trade norms and aligns with the rhetoric of ‘Europe’s strategic autonomy’.

China’s “Made in China 2025” strategy prioritises domestic production and balances foreign investment with the aim of achieving global leadership in high-tech sectors. This process, involving public procurement, technology transfer requirements and state-backed firms, is often criticised in Western literature as ‘state capitalism’ and ‘asymmetric competition’ (Kennedy, 2020; Naughton, 2018).

Similarly, India’s Atmanirbhar Bharat (Self-Reliant India) policy combines classic protectionist policies with modern development strategies, such as

import substitution, subsidies for domestic production and localisation targets in strategic sectors (Singh, 2021). Similar trends have been reported in Brazil under the Bolsonaro administration in sectors such as healthcare, defence, and agriculture, where domestic firms are prioritised and tendencies towards nationalisation are observed (Pinheiro & Costa, 2022).

These global examples demonstrate that today's economic nationalism is not merely a return to protectionist policies, but rather a multidimensional transformation centred on technological superiority, supply security and strategic independence. Unlike classical mercantilist approaches, today's economic nationalism is supported by not only trade policies, but also industrial policy, investment regimes and state-supported innovation strategies (Rodrik, 2023; Zhao, 2023a).

Various crises facing the world, such as security issues in Mali, the Russia–Ukraine war, the Kyrgyzstan–Tajikistan conflicts, and the ongoing Israel–Palestine conflict over land acquisition or ideological reasons, raise questions about the resurgence of economic nationalism and the limits of economic liberalism. These developments raise serious questions about the stability of the international system and the sustainability of the global economic order.

The pandemic has claimed millions of lives and increased migration, exposing the limits of economic liberalism and paving the way for nationalist ideas. Nationalism prioritises an intellectual construct called 'nation' and its claims, whereas liberalism is based on the principles of freedom and individual responsibility.

Historically regarded as harmful to societal, national, and international development, economic nationalism is increasingly being embraced in both the political arena, as evidenced by the rise in nationalist parties, and in the shaping of economic policies.

Table 1 below provides a systematic comparison of the objectives, tools and legal regulations of policies pursued by countries. In both developed countries (e.g. the United States and the European Union) and developing economies (e.g. India, Turkey and Indonesia), economic nationalist policies are observed to be implemented with similar objectives, albeit through different institutional and sectoral designs.

Table 1: Nationalist Policies Pursued by Countries

| Country/<br>Region | Key Policy Laws/<br>Initiatives (Year)                                     | Key Objectives                                                          | Main Tools                                                                 | Main Sources                                    |
|--------------------|----------------------------------------------------------------------------|-------------------------------------------------------------------------|----------------------------------------------------------------------------|-------------------------------------------------|
| USA                | Trade War Tariffs (2018); USMCA (2020); CHIPS Act (2022)                   | Technological autonomy; withdrawal of production; employment protection | Customs duties; subsidies; investment screening                            | Bown & Kolb 2021; Rodrik 2023; White House 2022 |
|                    | Inflation Reduction Act (IRA, 2022)                                        |                                                                         |                                                                            |                                                 |
| European Union     | Net-Zero Industry Law (2023); Critical Raw Materials Law (2023)            | Green industrial capacity; security of supply                           | Subsidies; regulatory targets; public funds                                | Zachmann et al. 2023; Meunier & Nicolaidis 2019 |
| China              | Made in China 2025 (2015-); Dual Circulation Strategy (2020)               | High-tech leadership; self-sufficiency                                  | Government incentives; public procurement; technology transfer obligations | Kennedy 2020; Naughton 2018                     |
| India              | Atmanirbhar Bharat (2020-)                                                 | Import substitution; encouraging local production                       | Customs duties; production incentives; local content rules                 | Singh 2021                                      |
| Brazil             | Industrial Policy Supports (2019-)                                         | Domestic industry protection; strategic autonomy                        | Tax cuts; incentives; public procurement priority                          | Pinheiro & Costa 2022                           |
| Turkey             | Domestic and National Technology Move (2019-); Defense Industry Incentives | Technology independence; defense industry development                   | R&D grants; localization requirements; public procurement                  | TÜBİTAK 2020; SSB Reports                       |
| Russia             | Substitution Program (2014-); Technological Sovereignty Plan (2020)        | Reducing import dependency; economic resilience                         | State loans; localization targets; import bans                             | Connolly 2018; RAE 2021                         |
| Indonesia          | TKDN Local Content Rules (2021-); Industry Value Added Program             | Increasing domestic industry; reducing import dependency                | Local content obligation; tax exemptions                                   | Indonesian Ministry of Industry 2022            |
| South Korea        | Korea New Deal (2020); Strategic Materials Act                             | Digital and green transformation                                        | R&D support; regulatory incentives; focused investments                    | KDI 2021; Ministry of Economy and Finance Korea |
| Mexico             | ProMexico (2017-2020); Strategic Sector Investment Incentives              | Strengthening the industrial base; export competitiveness               | Free zones; investment incentives; trade agreements                        | OECD 2020; Mexico Industrial Policy Review      |

The concept of economic nationalism has evolved beyond the confines of trade protectionism, attaining a more expansive significance as a developmental strategy. This evolution is characterised by the implementation of multifaceted instruments, including strategic industrial subsidies, public procurement, investment screening mechanisms, local content regulations, and supply chain restructuring initiatives. In the contemporary era, it is anticipated that these trends will undergo a period of consolidation, with the advent of green protectionist policies that are intrinsically linked to the climate crisis.

The concept of economic nationalism is not confined to industrial or investment policies; it is also manifest in the agriculture and food sectors. The global shocks of recent years – the pandemic of 2020, the Russia-Ukraine war, and fluctuations in food prices – have led to an increase in protectionist tendencies. These tendencies are aimed at reducing dependence on foreign imports in agriculture.

Since 2022, India has implemented export bans and quotas on basic grain products (wheat, rice) with the objective of balancing the domestic market and protecting strategic stocks (FAO, 2023).

In an effort to bolster domestic production, Turkey has implemented a range of support measures, including price incentives, purchase guarantees, and subsidies administered by the Turkish Grain Board (TMO). The primary objective of these measures is to ensure supply security, with a particular focus on wheat, barley, and corn.

China has incorporated domestic seed production into its strategic plans and prioritised the localisation of agricultural technologies with the objective of achieving independence from imported seeds (Zhao, 2023b).

Since 2014, Russia has undergone a transformation in its agricultural sector characterised by a rise in nationalist sentiment. This shift has been precipitated by the imposition of import bans in response to Western sanctions, and the subsequent imposition of export taxes on products such as wheat and sunflower (Wegren, 2016).

In Indonesia, the government has imposed taxes on strategic products, including palm oil and rice, and has initiated a “domestic seed campaign” (McCarthy, 2020).

In the context of the Bolsonaro administration in Brazil, a range of policy measures have been implemented with the aim of increasing domestic production. These include the introduction of tax advantages and import

restrictions, as well as a policy prioritising domestic consumption in the agricultural sector (Sauer, 2018).

In 2022, Egypt implemented a prohibition on the exportation of fundamental agricultural products, a measure adopted in response to the escalating costs of foodstuffs. The Egyptian government has placed a premium on the implementation of state-guided production policies for wheat, with the objective of fostering the development of a “national bread” campaign (Breisinger et al., 2022).

The European Union’s 2023 reform of its Common Agricultural Policy signified a pivotal shift towards the principle of strategic autonomy, with the overarching objective being to reduce reliance on imports (Matthews, 2023).

During the period of the Trump administration (2018-2020), the United States government allocated approximately \$28 billion in support to farmers adversely affected by the trade wars with China. This process coincided with the emergence of the concept of strategic protection in agricultural production (Bown & Kolb, 2021). Furthermore, the Biden administration has set its sights on augmenting domestic production capacity through strategic investments in agricultural infrastructure as part of the “Build Back Better” initiative. During the Biden administration, the “Build Back Better” plan, which included agricultural investments, did not come into direct effect, as most of its agricultural provisions were transferred to the Inflation Reduction Act (IRA) during the legislative process. Table 2 provides a comprehensive overview of the policies implemented in the agricultural sector.

*Table 2: Economic Nationalism in Agriculture*

| Country   | Type Of Policy                                 | Application Period | Example Application / Tool                  |
|-----------|------------------------------------------------|--------------------|---------------------------------------------|
| India     | Export restrictions                            | 2022–2023          | Ban on rice and wheat exports               |
| Türkiye   | State intervention/ subsidy                    | 2020–2023          | TMO purchase guarantees                     |
| China     | Localization                                   | 2016–              | Domestic seed production strategy           |
| Russia    | Export tax / import ban                        | 2014–              | Ban on food imports (Western products)      |
| Indonesia | Local content requirement / export restriction | 2020–2023          | Palm oil export tax                         |
| Brasil    | Tax incentives and import restrictions         | 2019–2022          | Import restrictions on non-Mercosur imports |
| Egypt     | Export ban                                     | 2022               | Wheat export ban                            |
| EU        | Strategic autonomy reform                      | 2023               | Import reduction target in CAP reform       |
| USA       | Farm subsidies / protectionism                 | 2018–2021          | \$28 billion in support                     |

These developments suggest that the agricultural sector has been incorporated into economic nationalism, not only with regard to food supply security, but also in terms of strategic autonomy and political legitimacy (Clapp, 2021; Margulis, 2013).

## 2. Literature

The relationship between economic nationalism and agricultural policies has become a significant area of research, particularly in the context of contemporary globalisation. The increasing integration of global trade has had a profound impact on the structure of the agricultural sector and the state's economic intervention tools in developing countries. This transformation has led to a re-evaluation of the theoretical and practical foundations of policies aimed at protecting national production and food security. In this context, economic nationalism is not only regarded as a form of trade protectionism, but also as a developmental strategy that promotes domestic production in key sectors. Furthermore, agricultural policies are being re-evaluated and reconfigured within the framework of this strategic approach. The following literature comprises fundamental studies that examine the historical origins of economic nationalism, its resurgence in

the face of globalisation, and its multi-layered relationship with agricultural policies from different theoretical and empirical perspectives.

Keyder (1987) posits that the pervasive property structure predicated on diminutive peasant producers in the post-1950 period engendered a conducive milieu for economic nationalism and populist development strategies. Concurrently, import substitution industrialization policies fostered rural production and domestic industry. The present study provides an important theoretical framework for explaining how development strategies were localized in countries on the periphery of the global capitalist system by revealing the connection between economic nationalism and the class foundations of agricultural policies.

Polanyi (1944) emphasises that the subordination of labour, land, and money to the market as ‘fictitious commodities’ leads to social and ecological destruction, and observes that societies intervene reflexively to protect themselves. It is demonstrated that agricultural policies are at the forefront of these interventions, revealing that land and food are determined by social needs rather than market logic. The transnational norm dynamics between international law and local regulations – such as the EU Common Agricultural Policy and member state practices – reflect how nationalist tendencies emerge and strengthen in agriculture.

Rodrik (1997) examines the pressures of globalization on national labor markets and social security systems. It is asserted that trade has the effect of increasing wage inequalities and eroding social institutions. In order to combat this, the recommendation is made to strengthen social insurance systems and to protect national policy instruments. Bhagwati’s (2004) “spaghetti bowl” metaphor is a useful illustration of the complex interweaving of bilateral and regional free trade agreements (FTAs) in the global trade system, thereby weakening the multilateral structure of the World Trade Organization (WTO).

As Wilkinson (2009) contends, since the 1980s, global agri-food companies have been targeting developing country markets, thereby effecting a transformation of local food systems in favour of global capital and concomitantly reinforcing oligopolistic structures. This transformation has the effect of reshaping agricultural policies that have been developed through economic nationalism, both within individual nations and across international borders. Rodrik’s (2011) “trilemma” model, which conceptualises the pressures of global integration on democratic legitimacy, is employed to analyse this issue. The model utilised is that of globalization, national sovereignty and democracy.

Shaffer (2018) posits that international economic law and trade agreements imperil social inclusiveness by constricting the scope of national policy. He engages with the impact of agricultural and industrial policies on the global trade order, employing the WTO and the EU as illustrative cases. The harmonisation of national agricultural policies with global norms in developing countries is a significant topic of debate in the literature on development law.

Nugroho and Lakner's (2022) study revealed that an increase in openness over the past four decades has had a contradictory effect on agricultural production and trade. On the one hand, it has promoted agricultural production and trade, but on the other, it has weakened small farmers' access to markets and food security. Furthermore, the study found that vertical integration has benefited large firms and excluded local actors. This process has been shown to limit domestically developed agricultural policies through economic nationalism, thereby increasing external dependency. It has also been demonstrated that the development of state-supported policies to mitigate these negative effects is necessary.

These studies underscore the necessity to appraise economic nationalism and agricultural policies not solely as economic instruments, but within the ambit of historical-social dynamics. They accentuate the significance of state intervention and national policy capacity in the context of globalisation's localising effects.

### **3. Data Set**

In this study, the relationship between economic nationalism and the agricultural sector was analysed using India, Turkey, Russia, Brazil, Egypt and China as case studies. These countries are among the large developing economies and have implemented economic nationalist policies to varying degrees in recent years. Furthermore, these countries are distinguished by their continued reliance on agriculture as a significant economic and social sector, a relatively high rural population density, and the extensive implementation of state-supported agricultural policies.

The Indian government has implemented a range of policies to promote industrial production, including the "Make in India" and PLI programs. Concurrently, it has identified the agricultural sector as a strategic area of importance, providing subsidies and support prices to ensure its viability.

Turkey has attracted attention with its policies that have continued to emphasise agricultural support and domestic production despite neoliberal

reforms in the 2000s; in recent years, economic nationalism has gained strength with rhetoric centered on “domestic and national production.”

Russia has adopted a policy of economic nationalism, which is characterised by the prioritisation of domestic interests and the protection of national economic interests. This policy has been further reinforced through the implementation of import bans and self-sufficiency policies in the agricultural sector. These measures have been adopted in response to Western sanctions imposed after 2014.

Brazil is a prominent agricultural exporter and a notable instance of a nation implementing nationalist development strategies through state-supported programmes in agricultural technology.

Despite the scarcity of resources, Egypt continues to prioritise economic independence through the implementation of subsidies and production support programmes in the agricultural sector, with a particular focus on ensuring food security. Furthermore, the country has implemented protectionist measures with a view to reducing its reliance on imports.

The People’s Republic of China is implementing a series of interventions intended to increase both high-tech production and agricultural production capacity. These interventions are part of the “Made in China 2025” and “dual circulation” strategies, which position agriculture and food security as part of the country’s economic security strategy.

The countries in question provide empirical examples that are suitable for examination in terms of state economic intervention, the economic weight of agriculture, their relationship with global trade, and economic nationalism strategies. This provides both diversity and contextual integrity for comparative analysis.

In this study, the variables “Share of Agriculture in GDP (gdpagr)” and “Openness Ratio (op)” were utilised to examine the effect of the level of openness to the outside world on the economic weight of the agricultural sector for the selected six countries for the period 1990-2024. The calculation of the GDPagr variable was undertaken utilising World Bank data, with 2015 constant prices designated as the percentage of real GDP accounted for by agricultural value added. It functions as a significant indicator for comprehending sectoral transformation and structural change processes. The op variable is indicative of a nation’s level of integration into the global economy. This variable is defined as the ratio of total exports and imports to GDP. This ratio is indicative of the extent to which countries are integrated into the global trading system, and also represents external competitive

pressure on domestic sectors. In particular, increased openness to the outside world in fragile sectors such as agriculture can have both positive and negative effects on domestic production. Despite the trade openness ratio not being defined as an indicator in the economic nationalism literature, it is a fundamental macroeconomic indicator representing the degree of integration into global markets (Rodrik, 1997; Nugroho & Lakner, 2022). The implementation of economic nationalist policies is typically effected through the utilisation of instruments that are designed to limit or direct such integration. Examples of such instruments include customs duties, export bans and local content requirements (Helleiner, 2002; Pryke, 2016). Consequently, a decline in the openness ratio can be interpreted as a trend consistent with the implementation of protectionist or domestic production-promoting policy sets.

The degree of openness is indicative not only of the volume of trade, but also of the extent to which the national economy is exposed to global competition. It is evident that policies such as protectionist tariffs, import quotas, or state support for strategic sectors can become empirical manifestations of economic nationalism. These manifest in a direct or indirect manner as a reduction in openness (Bown & Kolb, 2021; Evenett & Fritz, 2019). Consequently, the openness ratio emerges as a pertinent indicator variable, serving to quantify a single dimension of the multifaceted nature of economic nationalism: namely, the dimension pertaining to international trade policy.

It is widely accepted in the extant literature that an increase in openness tends to result in a reduction in the relative weight of the agricultural sector in developing countries. This phenomenon is associated with the mounting pressure of global competition on small-scale producers, the escalating trend of food imports, and the ongoing processes of rural transformation (Nugroho & Lakner, 2022; Wilkinson, 2009). Consequently, a negative relationship is anticipated between openness and the share of agriculture in GDP.

## 4. Method and Finding

### 4.1. Cross Section Dependency Tests

Cross-section dependency tests are utilised in the context of panel data analysis, with the objective of ascertaining the presence of cross-sectional dependency. The purpose of these tests is to ascertain whether the sections in panel data sets are independent of each other or whether their responses to common external shocks are similar. This phenomenon can be attributed

to the heightened sensitivity of nations to economic shocks originating from other countries, a consequence of the interconnected global economy, the prevalence of international trade, and the deepening of financial integration. A plethora of tests are documented in the extant literature for the purpose of measuring cross-section dependence.

#### 4.1.1. Breusch-Pagan LM Test

The Breusch-Pagan (1980) test is a statistical procedure that can be employed in the context of panel data analysis, provided that the time dimension (T) exceeds the unit dimension (N). The presence of low p-values is indicative of cross-section dependence in the error terms, thereby rejecting the null hypothesis. Breusch and Pagan proposed the following Lagrange multiplier (LM) statistic:

$$LM = T \left( \sum_{i=1}^{N-1} \sum_{j=i+1}^N \rho_{ij}^2 \right) \quad (1)$$

#### 4.1.2. Pesaran Scaled LM Test

The Breusch and Pagan test is not effective if the number of observations in the data set is large (N). Pesaran developed the following LM statistic to overcome this problem. In the case of  $N = \infty$ , it is appropriate to utilise Pesaran's (2004) Scaled LM test. The Breusch-Pagan LM test is not applicable when n approaches infinity. Consequently, Pesaran (2004) proposed a scaled-down version of the LM test, which can be written as follows:

$$CD_{LM} = \sqrt{\frac{1}{N(N-1)}} \sum_{i=1}^{N-1} \sum_{j=i+1}^N (T \hat{\rho}_{ij}^2 - 1) \quad (2)$$

The test utilises a scaled LM statistic in order to correct for biases that may be present due to the large size of the panel. The objective of this method is to mitigate potential biases that may emerge as a consequence of the substantial size of the panel.

#### 4.1.3. Pesaran CD Test

Pesaran (2004) posits that, under certain conditions, the Pesaran CD test can be applied when the sample size (N) exceeds the time dimension (T).

$$CD = \sqrt{\frac{2T}{N(N-1)}} \left( \sum_{i=1}^{N-1} \sum_{j=i+1}^N \hat{\rho}_{ij} \right) \sim N(0,1)_{i,j} \quad (3)$$

$\hat{\rho}_{ij}$  shows the correlation between errors. The null and alternative hypotheses used for the cross-sectional dependence test are as follows:

$$H_0 : Cov(u_{it}, u_{ij}) = 0$$

$$H_1 : Cov(u_{it}, u_{ij}) \neq 0$$

$H_0$  hypothesis suggests that there is no dependence between cross-sections,  $H_1$  hypothesis suggests that there is dependence between cross-sections. Finally, p-values are calculated to make a decision about the null hypothesis. If the calculated probability values are smaller than the significance values, the null hypothesis is rejected. Conversely, the null hypothesis cannot be rejected.

All three tests mentioned can be used for both homogeneous and heterogeneous panels.

#### 4.1.4. Bias-Corrected Scaled LM Test

The Bias-corrected Scaled LM Test was developed by Baltagi, Feng, and Kao (2012) to measure cross-sectional dependence in homogeneous panels. The present study proposes a modification of Pesaran's Scaled LM test, incorporating a bias correction to facilitate more precise detection of cross-sectional dependence in panel data sets. This correction assumes particular importance in cases where panel sizes (N) and time dimensions (T) are large, as biases in standard error estimates may increase in such cases.

This test finds application in the context of panel data analysis when  $T > N$ , where T denotes the time dimension and N the unit dimension. The test can be expressed using the following equation:

$$LM_{BC} = LM_P - \frac{n}{2(T-1)} = \sqrt{\frac{1}{N(N-1)}} [\sum_{i=1}^{N-1} \sum_{j=i+1}^N (T\rho_{ij}^2 - 1)] - \frac{N}{2(T-1)} \quad (4)$$

The results of the cross-sectional dependency test are presented in Table 3. The findings of the study indicated the presence of cross-sectional dependency in all variables.

*Table 3: Cross-Section Dependency Test Results*

| Variables      | Breusch-Pagan LM Test | Pesaran scaled LM | Pesaran CD | Bias-Corrected Scaled LM Test |
|----------------|-----------------------|-------------------|------------|-------------------------------|
| <b>LGDPAGR</b> | 425.746*              | 74.992*           | 74.903*    | 20.408*                       |
| <b>LOP</b>     | 106.207*              | 16.652*           | 16.564*    | 4.086*                        |

*Note \*, %1, indicates the level of significance.*

#### 4.2. Homogeneity Test

The unit root and cointegration tests to be performed in panel data analysis may vary depending on whether the variables are homogeneous or heterogeneous. The homogeneity test, as developed by Pesaran and Yamagata (2008), is also referred to as the delta test. This evaluates the hypothesis of homogeneity of individual slope coefficients in panel data, as well as deviations from the mean.

The Delta test is expressed as in equations 5 and 6:

$$\text{Standard Delta Test: } \Delta = \sqrt{\frac{N}{2}} \left( \frac{1}{N} \sum_{i=1}^N \hat{\beta}_i - \beta \right) \quad (5)$$

$$\text{Adjusted Delta Test: } \tilde{\Delta} = \sqrt{N} \left( \frac{1}{N} \sum_{i=1}^N \frac{\hat{\beta}_i - \beta}{\sigma_i} \right) \quad (6)$$

In this context, N denotes the total number of panel members,  $\hat{\beta}_i$  represents the estimated slope coefficient for the i'th panel member,  $\beta$  symbolises the average slope coefficient, and  $\sigma_i$  denotes the standard error of the estimated slope coefficient for the i'th panel member.

Pesaran and Yamagata (2008) formulate the hypotheses related to the Delta test as follows:

$H_0: \beta_1 = \beta_2 = \dots = \beta_n = \beta$  (For all  $\beta_i$ ) (Homogeneous), ( $i=1, \dots, n$ )

$H_A$ : At least one  $\beta_i$  is different from the others (heterogeneous)

If the calculated test statistic is greater than the table value, the  $H_0$  hypothesis is rejected and the panel is considered heterogeneous.

The homogeneity test results are presented in Table 4.

Table 4: Homogeneity Test Results

| Regression Modal                                                 | Standard Test |         | Adjusted Test |         |
|------------------------------------------------------------------|---------------|---------|---------------|---------|
|                                                                  | Delta         | p-value | Delta         | p-value |
| $lgdpagr = \alpha_{0i} + \alpha_{1i}lop_{it} + \varepsilon_{it}$ | 16.331        | 0.000   | 17.080        | 0.000   |

The results indicate that the p-values for both test types are less than 0.01. This finding suggests that the  $H_0$  hypothesis is to be rejected and that the slope coefficients are heterogeneous.

### 4.3. Unit Root Test

In this study, given the existence of cross-sectional dependence among the series (i.e. countries), the Covariate Augmented Dickey–Fuller (CADF) test proposed by Pesaran (2007) was utilised as one of the second-generation unit root tests. The Pesaran CIPS (Cross-sectional Im, Pesaran, and Shin) unit root test is utilised for the purpose of detecting the presence of unit roots in panel data sets. The present test was developed by Pesaran in 2007, and extends the original unit root test of Im, Pesaran, and Shin (IPS) to take into account cross-section dependencies. The Pesaran CADF test represents an extended version of the ADF regression, incorporating the cross-sectional averages of the first differences and lag levels of individual series. The CIPS test involves the application of the IPS test to each cross-section within the panel, resulting in the calculation of an average statistic from the obtained results. This enables the assessment of the presence of a shared unit root structure across all cross-sections of the panel. In the test, the individual results for each cross-section are obtained using the CADF statistic, while the results for the overall panel are obtained using the extended CIPS (Cross-Sectionally Augmented Im, Pesaran, and Shin) statistic, which is calculated as the cross-sectional average. The CADF test provides highly consistent results even when the cross-sectional (N) and time (T) dimensions are relatively small. Furthermore, it has been demonstrated that this test can be utilised in both  $T > N$  and  $N > T$  cases (Pesaran, 2007: 266-267).

The CADF stationarity test is expressed in Equation (7) as follows:

$$\Omega Y_{it} = \delta_i + \pi_i y_{i,t-1} + \beta_i \bar{y}_{t-1} + \Phi_i \theta \bar{y}_t + \mu_{it} \quad (7)$$

The introduction of a lag length (t-1) in equation 7 results in the following equation 8.

$$\Omega Y_{it} = \delta_i + \pi_i y_{i,t-1} + \beta_i \bar{y}_{t-1} + \sum_{j=0}^p \phi_{ij} \theta \bar{y}_{t-j} + \sum_{j=1}^p \psi_{ij} \theta y_{i,t-j} + \mu_{it} \quad (8)$$

In this context  $\theta y_{i,t-j}$  and  $y_{t-j}$  the mean of the initial lagged level and the difference at each cut-off, respectively. Pesaran (2007).

The CIPS unit root test is illustrated in equation 9 as follows:

$$CIPS = N^{-1} \sum_{i=1}^N \pi_i(N, T) \tag{9}$$

In the course of executing the Pesaran CIPS panel unit root test, the determination of lag lengths was conducted automatically in accordance with the Akaike Information Criterion. The results of the unit root test are presented in Table 5. As demonstrated in the table, the variables were found to be stationary.

*Table 5: Unit Root Test Results*

| Variables | Constant I(0) | Constant and Trend I(0) | Constant I(0) | Constant and Trend I(0) |
|-----------|---------------|-------------------------|---------------|-------------------------|
| LGDPAGR   | -0.795        | -0.108                  | -1.981**      | -1.337***               |
| LOP       | 2.183         | -0.896                  | -3.067*       | -2.025**                |

*Note \*, %1, \*\*%5, \*\*\* %10 indicate the level of significance.*

**4.4. Westerlund Cointegration Test**

In this study, the Westerlund (2007) Panel Cointegration Test was utilised. In 2007, Westerlund (2007) proposed four novel tests for panel cointegration analysis, based on structural dynamics as opposed to residual dynamics. The fundamental approach of these tests is to infer the existence of a cointegration relationship by testing whether the error correction term is zero in a conditional panel error correction model. These tests are sufficiently flexible to account for unit-specific short-term dynamics, unit-specific trend and slope parameters, and cross-sectional dependence, without imposing any common factor restrictions. Furthermore, the test statistics are found to be asymptotically normally distributed, thereby enhancing the reliability of the results. The panel cointegration tests developed by Westerlund (2007) evaluate the existence of a cointegration relationship through a structural approach that utilises an error correction model. The aforementioned tests boast a flexible structure that takes into account short-term dynamics, unit-specific constants and trend terms, and cross-sectional dependence in panel data sets. The Westerlund tests are classified into two main groups based on the nature of the alternative hypothesis used: Group-Mean Tests and Panel Tests.

Group-average tests posit the assumption that the error correction coefficient ( $\alpha_i$ ) can vary between units in the panel. In the context of these experiments, the null hypothesis is defined as follows:

( $H_0$ ), that there is no cointegration in any of the units, alternative hypothesis, ( $H_1^g : \alpha_i < 0$ ) indicates the existence of a cointegration relationship in at least one unit.

These tests are performed in three stages:

1. An error correction model is estimated for each panel unit using the least squares method.

Residual terms ( $\hat{u}_{it}$ ) are obtained from the estimated model.

The group average statistics  $G_\tau$  and  $G_\alpha$  are calculated using the obtained residuals.

The underlying assumption of panel tests is that the error correction coefficient ( $\alpha_i = \alpha$ ) remains constant for all panel units. In this particular instance, the null hypothesis ( $H_0$ ) signifies the absence of cointegration within any individual unit of the panel. Conversely, the alternative hypothesis ( $H_1^p : \alpha_i < 0$ ) denotes the existence of a cointegration relationship across all units.

These tests are also performed in three steps:

1. The first step is the same as the estimation process in group-average tests. In this step, the lagged values ( $\Delta y_{it}$ ) and the simultaneous and lagged values of the deterministic components ( $d_t$ )  $\Delta x_{it}$  are included in the regression analysis.

2. The common error correction coefficient  $\alpha$  and the standard error of this parameter are estimated.

3. Finally, the panel statistics are  $P_\tau$  and  $P_\alpha$  calculated.

Westerlund (2007) Panel Cointegration Test results are presented in Table 6.

*Table 6: Westerlund (2007) Panel Cointegration Test Results*

|            | Constant |         |         | Constant and Trend |         |         |
|------------|----------|---------|---------|--------------------|---------|---------|
| Statistics | Value    | Z-value | P-value | Value              | Z-value | P-value |
| $G_\tau$   | -0.125   | 4.505   | 1.000   | -2.779             | -1.243  | 0.107   |
| $G_\alpha$ | -0.832   | 2.839   | 0.998   | -14.372            | -0.850  | 0.198   |
| $P_\tau$   | 0.002    | 3.568   | 1.000   | -12.660            | -8.559  | 0.000   |
| $P_\alpha$ | 0.001    | 2.335   | 0.990   | -22.802            | -5.541  | 0.000   |

#### 4.5. Common Correlated Effects Mean Group (CCEMG) Method

In panel data models, cross-section dependency arising from unobserved common shocks among the error terms of the units weakens the validity of classical fixed effects (FE) or random effects (RE) estimators. This problem is more pronounced in data sets with common factor structures, which are common in economic models. The Common Correlated Effects (CCE) method, as pioneered by Pesaran (2006), represents a significant approach in addressing such dependencies, thereby ensuring the provision of consistent estimates.

The CCE approach is predicated on the indirect control of the effects of unobservable common factors by means of cross-sectional averages, as opposed to the direct estimation of these factors. The CCEMG (Common Correlated Effects Mean Group) estimator is a statistical method that calculates separate CCE estimates for each unit and then takes the average of these estimates. This approach permits the consideration of both heterogeneous coefficients and common factor structures.

The approach developed by Cao and Zhou (2022) enables the CCEMG method to be applied reliably in dynamic heterogeneous panel data models, particularly those with non-stationary common factors in the error structure. The present study has demonstrated the consistency of both the CCE (Covariance-Correlation Estimate) estimator, which estimates individual coefficients, and the CCEMG (Covariance-Correlation Estimate of Maximum Likelihood) estimator, which represents the average of these coefficients. Furthermore, it has been established that the CCEMG estimator is asymptotically normally distributed.

A salient feature of the method under scrutiny is its independence from a preliminary test for the stationarity of common factors. Furthermore, the CCE/CCEMG estimator exhibits resilience to factor structures of this nature. The findings, derived from Monte Carlo simulations, have substantiated that the CCEMG estimators are both unbiased and efficient, a propensity that is especially pronounced in scenarios where panel sizes are substantial. Furthermore, a Jackknife correction has been proposed as a means of reducing time series bias, and it has been observed that this correction provides a significant improvement in small samples.

In applications, the model is typically configured in the following manner:

$$y_{it} = \phi_i y_{i,t-1} + \beta_i x_{it} + \delta_i \bar{z}_t + \varepsilon_{it} \quad (10)$$

Here;

- $y_{it}$  : Dependent variable
- $y_{i,t-1}$  : Lagged dependent variable (dynamic structure)
- $x_{it}$  : Independent variable
- $\bar{z}_t$  : Cross-sectional means of observable variables (and lags)
- $\varepsilon_{it}$  : Error term
- Subscripts: i: unit t: time

In this context,  $\bar{z}_t$  encompasses the cross-sectional means of both y and x, in addition to their lagged values. This configuration enables the model to regulate the impact of shared factors. The CCEMG estimator is calculated by taking the average of the  $\phi_i$  and  $\beta_i$  estimates obtained from this equation for each unit i.

The CCEMG method is distinguished by its efficacy in heterogeneous and dependent panel data sets, particularly in the context of examining long-term relationships.

*Table 7: CCEMG Method Results*

| Variables | Coefficients | z-statistics | Probability |
|-----------|--------------|--------------|-------------|
| LOP       | -.0384       | -1.78        | 0.076       |
| Sabit     | 18.741       | 4.69         | 0.000       |
| Trend     | .025908      | 3.97         | 0.000       |

In the analysis, the Common Correlated Effects Mean Group (CCEMG) estimator developed by Pesaran (2006) was applied; thus, cross-sectional dependence and heterogeneity in the panel data structure were taken into account. The coefficient of the independent variable trade openness (LOP) on the share of the agricultural sector in GDP (LY) was estimated as  $-0.038$  and found to be statistically significant at the 10% level of significance ( $p = 0.076$ ). This finding suggests that a 1% rise in the trade openness ratio leads to an average reduction of approximately 0.038 percentage points in the share of agriculture in GDP.

The coefficient of the linear trend variable specific to the group in the model is 0.0259, and is statistically significant at the 1% level of significance ( $p < 0.001$ ). This finding suggests that there is an upward trend in the share of agriculture in GDP over time in most of the countries in the panel. Furthermore, in five out of the six countries in the sample (83.3%), the

trends defined at the group level were found to be statistically significant at the 5% level of significance.

The positive trend coefficient in the model indicates an upward trend in the share of agriculture in GDP over time. This finding appears to contradict the predictions of classical structural transformation theories (Chenery & Syrquin, 1975), however recent economic nationalist policies protecting agriculture, global food crises, and price increases are among the factors that could explain this trend (Clapp, 2021; FAO, 2023; Zhao, 2023b).

In addition, despite the anticipated adverse effect of openness in academic literature, there are studies that identify positive or U-shaped relationships in agriculture or food security. For instance, Sun and Zhang (2021) reported that the effect of trade openness on food security in Central Asian countries was initially negative but turned positive after a certain threshold level. Conversely, Dithmer and Abdulai's (2017) study revealed a positive correlation between trade openness and food security, as evidenced in a sample of 198 countries. In a similar vein, Gnedeka and Wonyra (2023) demonstrated that trade openness contributes positively to food security in Sub-Saharan Africa. The present examples lend support to the hypothesis that the positive trend coefficient is not an isolated phenomenon, but rather that complex, non-linear relationships between trade openness and the relative weight of the agricultural sector may be observed in specific contexts.

The cross-sectional mean of the lagged dependent variable (LY) is incorporated into the model with a coefficient of 0.246, which is determined to be significant at the 10% level of significance ( $p = 0.082$ ). This finding lends support to the hypothesis of the existence of a long-term equilibrium relationship within the model. However, the lagged cross-sectional mean of the trade openness variable was found to be non-significant ( $p = 0.508$ ). This finding suggests that the effect of trade openness does not demonstrate a uniform structure across countries, but rather exhibits variation by country.

The overall validity of the model was tested using the Wald  $\chi^2(1) = 3.15$  value and was found to be statistically significant at the 10% level of significance ( $p = 0.0758$ ). The model demonstrates a high degree of prediction accuracy, as evidenced by the root mean square error (RMSE) value of 0.0291.

In conclusion, it is understood that openness has a negative effect on the share of the agricultural sector in GDP at a 10% significance level, and that this relationship varies across countries.

## Results

The present study employs a rigorous empirical approach to examine the relationship between economic nationalism and agricultural policies through the utilisation of panel data analysis. The six countries selected for closer examination due to their implementation of nationalist policies in the agricultural sector are India, Turkey, Russia, Brazil, Egypt and China. The selection of these countries was based on their economic size and position in the global trade system. In the panel data analysis, the effect of the degree of openness (total exports and imports as a percentage of GDP) on the share of the agricultural sector in GDP was investigated.

Initially, cross-section dependency tests indicated the presence of a substantial cross-section dependency between the variables.

Consequently, the Pesaran (2007) CIPS test, a second-generation unit root test, was employed, and it was ascertained that the variables were stationary in their first differences. The outcomes of the Westerlund (2007) panel cointegration test indicate the absence of a statistically significant cointegration relationship between trade openness and the agricultural sector's share in the fixed model. However, a significant cointegration relationship was detected across the panel in the model, including a constant and trend. This finding indicates that the long-term equilibrium relationship is valid when the trend is taken into account. The CCEMG (Pesaran, 2006) estimation results, utilised in the empirical analysis, have indicated that the ratio of openness to the share of agriculture in GDP exerts a negative influence on the share of agriculture in GDP.

This finding suggests that openness has a mitigating effect on the relative importance of the agricultural sector.

Country-specific trends were found to be significant at the 1% level of confidence, and these trend coefficients were found to be positive. In the majority of the countries under consideration, an upward trend in the share of the agricultural sector in GDP has been observed over time. This finding stands in contrast to the predictions of classical structural transformation theories (Chenery and Syrquin, 1975), which anticipated a decline in the agricultural sector's share over time. However, an increasing trend has been observed in the countries under examination.

This phenomenon can be attributed to various factors, including the surge in economic nationalism witnessed in recent years, global food crises, concerns regarding supply security, and the escalating costs of agricultural produce (Clapp, 2021; FAO, 2023; Zhao, 2023b). As is evident in the extant literature, analogous trends have also been reported.

Sun and Zhang's (2021) study revealed that while the impact of openness on food security in Central Asian countries was initially negative, it exhibited a positive shift once a specific threshold was attained. Dithmer and Abdulai (2017) and Gnedeka and Wonyra (2023) demonstrated that, in specific circumstances, openness has the capacity to enhance food security and agricultural performance. The extant literature suggests that the relationship between openness and the agricultural sector is context- and policy-sensitive, and may exhibit non-linear or complex dynamics. Furthermore, the cross-sectional average of the lagged dependent variable was found to be significant, thus confirming the existence of a long-term relationship. However, the lagged cross-sectional average of trade openness is not significant, indicating that the effect of trade openness varies across countries.

In conclusion, in today's world where economic nationalism policies are gaining importance, it is observed that increasing trade openness reduces the relative share of the agricultural sector, but the effect is heterogeneous due to the different structural conditions of countries. The findings of this study indicate that policymakers should take into consideration country-specific variations when formulating policies pertaining to openness and agriculture. The heterogeneity of the effects of openness on the agricultural structure across countries necessitates the development of country-specific agricultural strategies, tailored to production and trade profiles. The implementation of economic nationalist policies, encompassing subsidies that protect domestic production, strategic stock management, and export restrictions, can serve as pivotal instruments in the preservation of the economic weight of agriculture. However, it is recommended that global integration be balanced not through complete liberalisation, but through certain protective measures for strategic products and the strengthening of domestic supply chains. It is recommended that future research analyse the threshold effects and nonlinear relationships of openness within the framework of economic nationalism. Additionally, factors such as price effects, productivity increases, and policy shocks that explain changes in agriculture's share of GDP could be included in the model. A comparative analysis of the effects across different income groups using a broader sample of countries would also contribute to the literature. The study demonstrates that, in general, openness has a tendency to diminish the relative significance of agriculture. Nevertheless, it is evident that economic nationalism strategies and country-specific conditions have the capacity to substantially modify this effect. The findings of this study can provide a valuable foundation for the future design of globalization policies and protectionist approaches toward the agricultural sector.

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## Reverse Innovation: A New Perspective on Globalization

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### Abstract

This chapter re-examines the dynamics of globalization through the lens of “reverse innovation.” Challenging the traditional model where innovations flow from developed to developing nations, reverse innovation describes the process whereby new products and services are first developed and adopted in emerging markets before being exported to the developed world. The study identifies several key drivers for this phenomenon, including significant “gaps” between developed and developing countries in performance needs, infrastructure, sustainability, and regulation. These unique local conditions in markets like China and India foster the creation of affordable, high-quality, and context-specific solutions.

Citing examples such as General Electric’s portable ultrasound machines developed for China and low-cost medical devices from India, the chapter illustrates how multinational corporations and local firms are leveraging these opportunities. The analysis argues that reverse innovation fundamentally alters the nature of globalization, transforming it from a unidirectional process into a multidirectional and more interdependent system. It counters the traditional product life cycle theory and suggests that emerging economies are no longer just recipients but are now significant sources of global innovation. While acknowledging the recent rise of protectionism, the chapter posits that reverse innovation offers a powerful strategy for firms to navigate trade barriers, access new growth markets, and redefine global industry standards. Ultimately, it presents reverse innovation as a key force shaping a more integrated and less hierarchical global economy.

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## 1. Introduction

The end of the Bretton Woods Monetary System in 1971 brought about significant structural changes in the global economy. The oil crisis that followed the collapse of the system accelerated the search for new policies. To address the unstable economic conjuncture that emerged during this period, a movement toward liberalization was initiated. Initially, liberalization focused on goods and services. The removal of barriers to capital facilitated the deepening of the globalization process. A significant milestone in this deepening was marked by advancements in the information and communication sector.

Activities aimed at innovation stand out as the main driving force of productivity and development. The development of such activities paves the way for innovations that are critically important in terms of high competitiveness and productivity. A significant contribution of innovation and technology to globalization is the enhancement of communication and connectivity. The advancement of the internet, social media, and mobile technologies has transformed the interactions between cultures and nations.

While the concept of globalization was initially associated with areas such as finance, production and culture, the concept of globalization of innovation has become increasingly widespread in the following years. Scientists, governments and international organizations have made efforts to assess the changes in technological activities that have occurred with increasing globalization. Although learning processes are lengthy and hard, the transfer of technological information between people has met with less opposition than changes in cultural, religious, social, or political habits. Technology has always provided a fertile meeting ground for many societies (Archibugi and Iammarino, 2003).

Globalization eliminates geographical barriers, while innovation and technology expedite this process by supplying essential means for the transfer of commodities and services and the dissemination of information. In this context, innovation has become an important field that makes positive contributions to the world's globalization process.

In recent years, the increasing innovation activities from developing countries to developed countries have attracted attention. These innovation activities, which are carried out under specific conditions and are characterized by their own unique features, are referred to as reverse innovation. The phenomenon of reverse innovation has transformed the nature of globalization, which has historically progressed from developed

countries to other regions of the world. Contemporary developing countries have emerged as significant contributors to the process of global integration.

The aim of this study is to discuss reverse innovation in a conceptual framework and to discuss its connection with the phenomenon of globalization. For this purpose, following the introduction section, the background on innovation and reverse innovation is presented. Subsequently, the interplay between innovation and globalization is thoroughly examined. Finally, the study is completed with the conclusion section.

## 2. Innovation Theoretical Background

Economic analyses since the last quarter of the twentieth century reveal two significant patterns in the global economy. First, technological innovations are contributing more than ever to economic prosperity. Second, nations in the world economy are becoming increasingly globalized and more interdependent. These two trends are strengthening in an interrelated manner. The expeditious exchange of information and the establishment of intimate connections among innovation ecosystems across various nations enhance the process of invention and the dissemination of novel concepts (Grossman and Helpman, 1991). Thus, the possibility of accessing the global knowledge required for economic growth, adapting it to local needs and having the ability to create new technology increases.

Joseph Schumpeter has made great contributions to economic growth theories with his views that emphasize the relationship between innovation and economic activities. Schumpeter defines innovation as an activity that leads to a new production function or a new product. In his “The Theory of Economic Development” in 1934 and “Capitalism, Socialism and Democracy” in 1942, Schumpeter argued that innovation is the force behind economic growth. Schumpeter identifies the five requirements for a product or service to be evaluated within the framework of “innovation” (Schumpeter, 1934):

- The development of the manufacturing of a previously unused good in society,
- Implementation of a new method in production,
- Opening a new market,
- The discovery of a new input source,
- Realization of the reorganization of industries.

Schumpeter defined “new” as a dynamic that is different, unique and leads to increased productivity and profits. Innovations cause old ideas, technologies, skills and equipment to become obsolete, in a sense obsolete. Innovation is a process that constantly renews and develops itself. This process is based on continuous innovation. Innovation is based on setting goals, designing and organizing the process well, continuously monitoring progress, and effectively planning goals, process and organization when necessary (Boer and During, 2001).

Schumpeter’s innovation and technology studies have been the starting point of the endogenous growth theories developed in the following years. Romer, (1986), one of the pioneers of endogenous growth theories, defined innovation as the main driving force behind growth. According to Romer, technological innovation is created by utilizing human capital and the existing stock of knowledge within the R&D system. The technological development obtained as a result of innovation contributes positively to capital accumulation and plays an important role in the realization of output per worker and thus growth.

Taymaz, (n.d.) argues that there have been three transformations affecting technological development since the 1980s. While before 1980, it was sufficient to master a single technology to produce a product, after this period, different technologies including know-how such as electronics and software started to be used. This technological development has revealed the necessity of R&D activities in order to produce innovative products and increased R&D activities have also increased fixed costs. All these increased innovative product developments have also increased uncertainties and risks depending on both consumer preferences and the possibility of competitors to develop better products.

Because of these three transformations, it is not possible for even the largest firm in the world to produce/develop all products/technologies related to a product or technology on its own. In other words, the innovation process is increasingly moving beyond the boundaries of one firm, and innovations can only be realized through interactions and collaborations between firms. This situation necessitates a systems approach for understanding the innovation process, and multiple firms and/or technologies need to be considered as a whole. In this context, as innovation activities and technology increase, globalization is necessarily realized.

At present, innovation is recognized as a key concept that increases competitiveness for firms and improves economic performance for national economies. The innovation system created in firms makes it possible for them

to become strong in the national and even international market. Therefore, innovation has become one of the most important topics emphasized by policy makers in both industrial and regional areas.

### 3. Reverse Innovation

Globalization provides both opportunities and challenges for firms in emerging economies. Competitive pressures push these firms to innovate to maintain their production and ensure their continued survival. The need to innovate has led some emerging economies such as China and India to become innovation hubs over time, leading to the emergence of the concept of reverse innovation (Gwarda-Gruszczyńska, 2016).

The important feature of reverse innovation is the focus not only on the price of the product but also on its quality. Hence, the product produced is not only cheaper, but also of high quality. Govindarajan and Ramamurti (2011), define reverse innovation as a process in which an innovation is adopted in developing (low-income) countries before it is implemented in developed (high-income) countries.

Although reverse innovation and glocalization are similar in definitions, they have fundamentally different characteristics. Glocalization is the process of selling international companies' products to domestic markets by adapting them to the cultural and vital structures of the export countries. In reverse innovation, new products are created from the ground up and exported to developed markets (Von Zedtwitz et al., 2015).

Reverse innovation is practiced by developing country firms as well as by international firms that come to access potential markets in these countries. The recession in developed economies in recent years has put firms in a difficult situation. International firms in these countries are increasingly faced with market stagnation and financial instability. In contrast, the large, growing and untapped customer base in developing countries has attracted the attention of these international firms seeking sustainable growth and new market opportunities (London and Hart, 2004).

The reverse innovation process created by international firms can be summarized as follows; first of all, firms focus on emerging markets while formulating their growth plans for the future. After researching the structure of the emerging market, firms formulate a growth strategy and identify the first target consumer group. Then, taking into account local needs and realities, they produce specific products and introduce them to the local market. After a certain period of time, these innovative products are exported to high-income countries (Hadengue et al., 2017). At the same

time, the most important point to be emphasized is that the first market target for innovative products is consumers in developing countries.

According to Govindarajan and Trimble (2012), reverse innovation will have a significant impact on core markets, and firms that disregard this process may find themselves unable to maintain their leadership position in the global market. In the context of this phenomenon, prominent international corporations have initiated reverse innovation practices. For instance, General Electric developed a portable ultrasound machine tailored to the Chinese market in the early 2000s. These machines were developed in China and initially offered to the domestic market. They were later successfully introduced to Western markets. Natural and herbal medicines that have been utilized in India for centuries have been synthesized in Western pharmaceutical laboratories and marketed to consumers in the United States and Europe as FDA-approved medications. Low-cost baby warmers, which were designed in India with the objective of preventing high infant mortality, have been exported to 75 countries. The Gatorade energy drink was initially developed to treat patients afflicted with cholera in South Asia; however, in subsequent years, it was fully commercialized as an energy drink on the global market. Nokia's strategic decision to develop its products in its Beijing R&D laboratory and to initially target the Chinese market, prior to their European launch, is indicative of a deliberate and calculated approach to market entry and expansion (Vadera, 2020; Von Zedtwitz et al., 2015).

The success of innovation activities in developing countries is not necessarily indicative of their potential for success in developed markets (Hadengue et al., 2017).

Govindarajan and Trimble, (2012) say that reverse innovation requires a significant development gap between developed and developing countries in key areas, including performance, infrastructure, sustainability, regulation, and consumer preferences. These differences, which are necessary for reverse innovation, are explained below (Govindarajan and Trimble, 2012; Gwarda-Gruszczyńska, 2016):

*The performance gap:* Income levels among consumers in developing countries are significantly lower than those of citizens in developed countries. Consequently, it is improbable that products resulting from innovation activities in developed countries will be in demand in developing countries. The solution to this situation is to develop an innovative product with at least reasonable performance, created from scratch and at a lower cost. This will result in increased demand for this novel performance and inexpensive,

innovative product from consumers affected by the economic downturn in developed countries.

*The infrastructure gap:* In developed countries, the majority of citizens have access to modern transportation, communication, and energy systems, as well as schools, hospitals, and banks. However, in developing countries, infrastructure services are still in the process of being developed. The absence of adequate infrastructure products and services can create an environment conducive to the development of innovative solutions.

*The sustainability gap:* As global economies continue to expand, the tension between economic activity and environmental sustainability is escalating. As developing countries continue to implement more aggressive industrial development strategies, there is an increasing emphasis on environmental sustainability. For instance, the issue of air pollution in certain Chinese cities has reached crisis levels, representing a substantial problem that demands immediate attention. China's notable advancements in the field of electric vehicle (EV) technology can be attributed to this strategic approach.

*The regulatory gap:* The regulatory systems in place in developed countries are the result of decades of development. In developing countries, the necessity for constant updating may be more pressing. In this context, under certain circumstances, developing countries can become a more favorable environment for innovation.

*The preferences gap:* A broad array of tastes, preferences, and habits is exhibited by societies around the world. In the context of developing countries, certain flavors have garnered significant attention from Western societies.

The disparities in developmental trajectories between advanced economies and emerging markets have given rise to a process of reverse innovation. Recent innovations in these countries, spearheaded by China and India, have enabled their citizens to access more affordable and superior quality products and services. Concurrently, the export of these products and services contributes substantially to national economies. Consequently, globalization has evolved from a unidirectional phenomenon to a multifaceted, all-encompassing phenomenon that has impacted all nations.

#### **4. Globalization, Innovation-Reverse Innovation**

Globalization brings increased inter connectedness and improved exposure to innovations from around the world, providing opportunities for sharing ideas and scaling innovations (Harris et al., 2020). The advent of

globalization has greatly expanded access to information and the emergence of new markets, leading to increased international competition and the proliferation of new forms of organization. The process of globalization, which has deepened mainly in economic and social dimensions, has led to the dissemination of the perception of competition from the national framework to the international level. This development has rendered it compulsory for businesses to innovate.

A significant consequence of globalization on the world economy is the intense competition in national and international markets. While this intense competition has positive consequences for consumers in international markets, such as reduced prices, it also poses significant challenges for producers, including concerns regarding product quality, production technology, technological developments, and the enhancement of marketing standards. In this regard, firms aspiring to expand into global markets must prioritize enhanced efficiency and cost reduction in their operations. The most effective strategy for enhancing competitiveness in global markets by increasing efficiency and reducing costs is through technological innovation.

Since Vernon, (1966; 1979) proposed the product life cycle theory, industrially developed countries have been the center and source of global diffusion of innovation. According to this traditional view, new products and technologies are first developed in developed countries and introduced to the domestic market, and after a certain period of time, they are exported to developing countries. In this context, the direction of innovation is from developed countries to developing countries, both in terms of technology and market (Von Zedtwitz et al., 2015).

Cutting-edge innovations have historically been developed in high-income countries, thereby limiting their global accessibility due to the challenges of affordability in developing nations (Sela, n.d.). However, the innovation success of emerging economies in recent years provides evidence that this situation is being reversed. While emerging markets transfer innovation from developed countries, they also sometimes offer products resulting from innovative activity to the rest of the world, including developed countries. This process is referred to as the concept of “reverse innovation”. This approach involves producing innovative goods and services in emerging markets before expanding into larger economies. Reverse innovation focuses on the spread of innovation activities of underdeveloped and developing countries throughout the world along with globalization.

## 5. Conclusion

Tariff policies, which have recently gained prominence in numerous countries, particularly in the US, have precipitated a shift from free trade to protectionism. The escalation of protectionist policies is widely regarded as a pivotal factor that has precipitated a shift towards a new era, one in which the phenomenon of globalization has experienced a notable deceleration in its progress, while regional economic blocs have undergone a marked rise in their geopolitical significance. However, multinational companies that adopt reverse innovation strategies experience various benefits, including the ability to overcome existing limitations, explore new markets, and foster growth.

The concept of reverse innovation holds the potential to significantly impact the global economic landscape by facilitating the realization of a unified global market. Developing countries represent lucrative markets for international companies, offering opportunities for growth, capitalization, and market consolidation. As the world increasingly embraces reverse innovation, it has the potential to transform industry standards and expand global expansion prospects for the better (Sela, n.d.).

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# **The Age of Economic Nationalism: The End of Globalization?**

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