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Protectionism: Risk of a trade war with the US?

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The announcement by the US President, Donald Trump, to levy import tariffs on steel (25%) and aluminium (10%) has made waves. Can the favourable economic environment of boom, low inflation, and gradual reduction of the supportive monetary policy be toppled?

Measure does not come as a surprise

Even during his election campaign, the President had declared himself against free world trade. Some of his core statements made reference to nationalism (“America first”) and were against multilateral rules. The most important arguments presented are:

1) a current account deficit is generally bad. However, there is no economic proof to substantiate this claim. Is a country really supposed to produce all goods and services “in-house”? No empirical data substantiating this notion exist.

2) Some trade partners act unfairly. This claim refers mainly to China, and it does hold some water. China has flooded the world market with goods on the back of governmentally subsidised overcapacities.

3) International organisations and multilateral treaties are not particularly useful. This also refers to the WTO. It is true that the countries of the WTO have not been able to agree on a much-needed new regulatory framework in 20 years. However, the conclusion that therefore a unilateral course of action is better cannot be substantiated by data.

4) In the USA, protectionist measures are popular.

Disturbing modus operandi

The way the US government has been handling this situation is disturbing for three reasons: According to the rules of the WTO, protective tariffs may be levied in some cases: strongly rising imports, subsidies, or sales prices below costs. In exceptional cases, danger to national security can also be cited. Given that the “ordinary” cases do not apply, the US administration has actually quoted the latter one.

This challenges the plausibility of the reasoning, since the overwhelming majority of steel and aluminium imports come from countries the USA is friends with; some of them are even NATO members. The statement by the US President that trade wars are good and easily won has alienated many.

Escalation risk

The risk of escalation has increased. The tit-for-tat strategy can easily get out of hand.

1) The countries affected by the US tariffs could levy their own tariffs on imports from the USA.

2) Other countries could levy tariffs on steel and aluminium in order to protect their domestic sector.

3) If the likely lawsuits against the US measures were dismissed by the WTO Court, others could also come up with the idea of imposing tariffs for reasons of national security.

4) This would question the entire regulatory framework of the WTO.

Stagflationary effect

Generally speaking, tariffs on certain products increase the price level of imports. This supports the domestic producers of steel and aluminium. Theoretically, the sales prices and profits of the steel and aluminium producers outside of the USA could come under pressure as a result.

But to a certain degree, the import prices and costs for other companies that process steel and aluminium in the USA will increase. This will partially eat into the profits of these companies, and partially consumer prices will rise. Given that company profits and consumer income do not increase at the same extent, the disposable income will fall, dampening economic growth. Result: higher prices, lower output.

Direct effects not relevant

In terms of GDP, the announced measures are not relevant. Last year, the aggregate amount of goods and services produced amounted to USD 19,738bn (source: OECD). The steel and aluminium industries account for about 0.3% of GDP. Steel and aluminium imports account for less than 0.3% of GDP.

Since the NAFTA partners Canada and Mexico as well as Australia are at least temporarily exempt from tariffs, these values will be still lower. Canada makes up the largest share of imports both in steel and aluminium. Australia is of little relevance.

Conclusion:

The tariffs on steel and aluminium will not have any significant effects on economic growth or inflation. It is “only” the course of action that is disturbing, fuelling the risk of escalation.

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