The dangers of Donald Trump’s trade brinkmanship

From the late 19th century to the 1980s, Minnesota’s iron ore mines had a monopoly in supplying the American steel industry. Then, transportation costs declined and Brazilian ore producers were able to beat the Minnesotans on price. The Minnesota mining companies responded by doubling productivity in the next five years. There is an obvious lesson here. If only US President Donald Trump cared to take note. The steel and aluminium tariffs he announced last week have not yet been implemented. But with the resignation of Gary Cohn as national economic council director over the tariffs, the chance that he could be talked out of them have plummeted.

The tariffs make little economic sense domestically. They will subsidize a couple of hundred thousand workers in the American steel and aluminium industries by imposing a de facto consumption tax on American consumers and soaking downstream industries that employ some 6.5 million workers. Those industries also make up a sizeable chunk of US exports, from industrial machinery to electronics. That is not particularly helpful to Trump’s enthusiasm for narrowing the US trade deficit.

It will also be interesting to see how the federal open market committee of the Federal Reserve sees this. Along with expansionary fiscal policy, tariff hikes could push inflation and force the Fed to raise rates at a faster pace than currently estimated.

There are a number of other potential risks as well.

First, ironically enough given that China is the primary target of Trump’s ire, the tariffs could end up boosting its steel industry. Chinese overcapacity has been a genuine problem since the early 2000s and targeted tariffs and anti-dumping measures are valid tools to address it. Partly because of over 400 such measures implemented by prior administrations, China now accounts only for a little over 2% of American steel imports—0.2% of Chinese output. Trump’s global tariffs will thus do little to address the China problem. Chinese trans-shipment, meanwhile, would have been best addressed by working with trade partners like Canada and the European Union (EU), both of which have expressed concern about it. Instead, the tariffs will end up inflicting substantial damage on them—particularly Canada, which accounts for almost 17% of the US’ steel imports.

This would leave Chinese companies well placed to beat out rivals in the increased competition in non-US markets. Although Chinese steel production is expected to slow in 2018 given Beijing’s focus on consolidation and curbing pollution, the past two decades have shown the skewed outcomes of market dominance by China’s state-owned behemoths.

Second, the increased competition could trigger a price race to the bottom. This risk increases if the EU implements the safeguard restrictions it is mulling in order to guard against a surge of steel and aluminium imports diverted from the US market. The excessively cheap metals that will flood markets like India’s in such a scenario will benefit some sectors but hit domestic Indian producers—not yet out of the woods—hard. And other countries could follow the US and possibly the EU’s lead, throwing up barriers against import surges. Such a rise in protectionism would benefit no one.

Third, Trump’s tariffs run the risk—admittedly minor, alarmist commentary notwithstanding, given that other countries are likely to reckon the costs too high—of triggering a broader trade war. China will keep its powder dry for now, but it is eyeing US sorghum imports as a shot across Washington’s bow. These don’t amount to much, but restrictions on US soybean imports could be the next step. Those would be much more substantial. The EU’s planned retaliatory measures, meanwhile, amount to about $3.5 billion. Trump has scoffed that this is chump change. He is correct. But he has also threatened to raise barriers to EU car imports, pointing to the risk of an escalatory spiral.

Fourth, the World Trade Organization's (WTO's) relevance is under threat. Trump invoked Section 232 of the Trade Expansion Act of 1962 for his tariffs. These allow for national security trade barriers, nonsensical in this instance. Brussels could take this to the WTO. This is a catch-22. If the WTO process is as interminable as usual, other countries may well decide to bypass it and follow Trump's lead now that he has broken the implicit international agreement not to invoke Section 232. If the WTO rules against the US, on the other hand, there is a fair chance Trump will ignore the ruling. The WTO is frequently toothless and ineffective, but making it more so is not a solution.

A few days ago, Trump tweeted that trade wars are good and easy to win. He should take a look at the trade restrictions imposed by George W. Bush and Barack Obama. A number of studies have pointed to their doing more harm than good. Lightly informed economic adventurism by the US president is not good for the US and it is not good for the world.

What will be the costs of the American steel and aluminium tariffs for the global economy? Tell us at views@livemint.com

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