

Tariff on Steel is Sparking Trade War

by Andrew Brod
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A good old-fashioned trade war is brewing. Trade wars never really went out of style, but in recent years they've been masked by concerns over non-trade issues such as labor standards and the environment. But in the latest round of disputes, the gloves are off. Protectionism is back!

Earlier this month, President Bush ordered a three-year tariff on most imported steel. The tariff starts at 30 percent in the first year and drops off gradually. The Bush tariff is startling for a number of reasons, for its brashness, for its bald political calculation, and for its inconsistency with Republican rhetoric about free trade.

The steel tariff is brash because in recent years, countries tend to justify trade barriers by pointing to some unfair or inappropriate action on the part of the exporting country. Perhaps the offending product violates health standards, or maybe it benefits from unfair subsidies. The protectionist instinct lurks just below the surface, but the other issue allows the tariff-setting government to claim that it's merely reacting to others' misdeeds.

However, the Bush tariff is based on no such claim. The justification is merely that the U.S. steel industry is hurting. And that much is certainly true. There is a glut of steel on the world market, and prices are low. Since 1997, over 30 U.S. steel makers have filed for bankruptcy protection. The president claims that U.S. law requires him to impose a tariff in this situation, but the implication is clear: this is unalloyed protectionism.

Observers expected the tariff to be set lower, in order to keep from hurting the many U.S. industries that use steel. Among those caught off-guard by the size of the steel tariff was the European Union, and they're hopping mad. European steel makers claim that they suffered the pain of retooling and upgrading in order to remain competitive, but that the U.S. wants to be exempted from the rules of the market.

Both South Korea and the EU say they will challenge the U.S. tariff under World Trade Organization rules. But it can take up to two years for the WTO to resolve disputes like this, so we're sure to see a series of retaliatory gestures by our trading partners.

Since the steel tariff was announced, the EU has created a "hit list" of American products on which it may decide to impose punitive tariffs. Textiles and apparel are featured prominently on it. The EU has yet to reach a final decision on its course of action, but it could cost us more jobs than the steel tariff will temporarily save. And this week, the EU announced a tariff on increases in steel imports into Europe.

In addition, the EU has proposed setting tariffs on non-European airlines that benefit from government subsidies, such as the \$15 billion U.S. carriers have received since September 11th. European carriers are also hurting, but without the big bail-out the

American airlines received. The U.S. government has frequently complained about government subsidies in other countries, so now that shoe is on the other foot.

The uproar over the steel tariff isn't limited to the EU. The Bush administration tried to soften the effect of the tariff on Russia, which the U.S. wishes to keep as an ally in the war on terrorism. But it will hit Russian steel nevertheless, and the Russians are now pushing a ban on chicken imports from the U.S. They claim that American chickens are full of salmonella and antibiotics that violate Russian food laws. American officials say our chicken is perfectly safe.

Would there have been an airline tariff or a chicken ban if not for President Bush's steel tariff? It's hard to say, but it's a darned good question. In any case, the retaliatory measures aimed at the U.S. could add to the general rancor in trade circles and make the next round of WTO negotiations virtually impossible. We should remember that as the world's sole remaining superpower, we benefit hugely from a stable global economy and trading system.

But the Bush administration doesn't seem to see it that way. Since the steel tariff, the administration has announced it will hit imports of Canadian softwood lumber with a 29 percent tariff, due to allegedly unfair subsidies enjoyed by lumber companies that log public forests in Canada. This is a strange accusation for the U.S. to level, given that the environmental lobby here has long criticized the array of monetary and non-monetary subsidies our government provides to private businesses that log national forests. Canada's response? New tariffs as high as 71 percent on American-grown tomatoes.

You have to give the President credit for chutzpah on another front as well. After a busy month of protectionism, he recently went on an important trip to Latin America where he lectured those countries on "opening markets." Of course, that's the protectionist's ideal: close one's own markets but open up everyone else's.

What about the effects of these tariffs? The Canadian lumber in question accounts for about a third of U.S. consumption for home construction. One estimate is that the lumber tariff will add about \$1,500 to the price of the average new home, and will force nearly a half-million people out of the housing market.

If you listen to the steel industry, the steel tariff will have either no effect or very little effect on prices of goods that contain steel. I trust nobody buys that line. A lot of products contain steel, from consumer goods like automobiles and computers to producer goods like factory equipment. Small manufacturers that use steel will be hit especially hard, because they are less likely to enter into long-term contracts that lock in steel prices for extended periods. And of course any increased costs will get passed on to some extent to consumers.

The effects won't stop with consumers. The Bush administration claims that the steel tariff will allow the industry to recover and retool, but in reality that process will be delayed as long as the tariff is in place. Nothing promotes innovation and recovery like

competition, and nothing eliminates competition like a tariff. Another effect will be to push already-low steel prices in Europe even lower. Falling steel shipments to the U.S. will cause more of the world's oversupply of steel to be shipped to Europe.

And then there's the precedent a policy like this can set. Already, other industries have been emboldened to step up and say that they deserve protection as well. Recently, the governors of North Carolina, South Carolina, and Georgia wrote a letter to President Bush asking for assistance in protecting the textile industry from foreign competition. Their letter specifically mentioned federal assistance for the domestic airline and steel industries.

What's the real reason for the steel tariff? Everyone except the Bush administration points to the close Presidential races in the steel states of Pennsylvania and West Virginia. In 2000, Bush lost the former and won the latter, and his strategists undoubtedly want to firm up Republican support in both states. Reportedly, West Virginia voters went for Bush in 2000 because former President Bill Clinton refused twice to impose protectionist trade barriers on behalf of domestic steel.

And the political game isn't just domestic. The steel tariff is designed in such a way to exempt most steel imports from Turkey and to lessen the blow on Russia (though Russia doesn't see it that way). Both of these countries provide important staging areas and support in the war on terrorism.

Perhaps the most surprising aspect of President Bush's steel tariff is how it contradicts Republican campaign rhetoric on open markets and free trade. Economists have long argued for free trade as the best starting point for international policy. Protectionism has been shown again and again to have only localized and temporary economic benefits. For society as a whole, protectionism is a bad deal, and Republicans have been arguing this point for decades.

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