IB Economics - internal assessment coversheet

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Donald Trump moves towards imposing tariffs on steel imports

The US has set the stage for a global showdown over steel, launching a national security investigation that could lead to sweeping tariffs on steel imports in what would be the first significant act of economic protectionism by President Donald Trump.

The decision to use a 1962 law allowing the US government to limit imports that threaten its security readiness is intended to deliver on Mr Trump's campaign promises to bolster heavy industry and "put new American steel into the spine of this country", officials said on Thursday.

But it risks setting off trade tensions with China just days after Mr Trump avoided another conflict by backing down on a promise to label Beijing a currency manipulator, citing in part its help in dealing with North Korea.

Mr Trump called the move a "historic day for American steel" but insisted it "has nothing to do with China".

"Steel is critical to both our economy and our military. This is not an area where we can afford to become dependent on foreign countries," he added.

The new push on steel came as Christine Lagarde, the head of the International Monetary Fund, repeated a warning that protectionism represented a serious threat to global growth.

But Ms Lagarde, who has been locked in a rhetorical battle over protectionism with Mr Trump's commerce secretary, Wilbur Ross, sought to reach out to the White House by acknowledging a need for changes in global trade.

Echoing some of Mr Trump's criticism of the multilateral system, the former French finance minister said there were increasing signs countries were violating global trading rules. She also concurred with the Trump administration's recent criticism of Germany, saying that addressing Berlin's trade surplus was "highly desirable".

Mr Trump's move on steel drew praise from both US industry members and labour unions. "This executive order will give us the tools we need to lure our companies back and [put] our people back to work," said Leo Gerard, head of the United Steelworkers union.

Mr Ross said the administration was concerned that rising steel imports were threatening US industry and its ability to respond quickly to national security needs. The issue was particularly relevant now because of Mr Trump's plans to increase spending on defence programmes such as new warships that rely heavily on steel, he added.

The US has in recent years launched 152 steel anti-dumping cases, with another 25 pending, but Mr Ross said the trade dispute system was "porous" because it allowed only narrowly focused complaints against specific countries.

"We're groping here to see whether the facts warrant a more comprehensive solution that would deal with a very wide range of steel products from a very wide range of countries," he said.

Any such action by the US would be likely to hurt steel producers in Europe and Asia and trigger reprisals.

The US steel industry has blamed Chinese overcapacity for driving down global prices and causing it to close mills and lay off workers. The industry is now operating at only 71 per cent of its capacity, with imports accounting for more than a quarter of the domestic steel market, Mr Ross said.

While Mr Trump has promised a hardline trade policy since taking office in January, his biggest action to date has been to pull the US out of a vast but never finalised 12-country Pacific trade deal.

Most other moves have been largely rhetorical. Mr Trump launched studies of US trade deficits and Buy American laws, and while he has vowed to renegotiate the North American Free Trade Agreement, thus far discussions with Canada and Mexico have been tentative.

In a trip through Asia this week, Mike Pence, the vice-president, warned South Korea that the US wants to re-negotiate trade deals that it feels have only added to the US trade deficit, and Mr Trump has held early talks with China over a trade deal.

While those initiatives remain in the pipeline, there have been few of the concrete policies advocated in Mr Trump's campaign that were central to his economic nationalist message and helped him win industrial states such as Ohio and Michigan.

The slow start on trade has come in part because Congress has yet to confirm his pick for US trade representative, Robert Lighthizer, which has frustrated an administration desperate to notch up accomplishments in its first 100 days.

Mr Trump said the steel study’s recommendations could come within a month. Mr Ross made clear he believed the investigation would lead to tariff actions and what would mark the first concrete protectionist moves by an administration that until now has been more focused on commissioning reports.

“Only the president’s actions based on those reports can show us his true colours on trade,” said Scott Lincicome, a White & Case trade lawyer also affiliated with the libertarian Cato Institute.

Chad Bown, a senior fellow at the Peterson Institute for International Economics and a former economic adviser to President Barack Obama, said citing “national security” on steel amounted to invoking a “nuclear option” in trade.

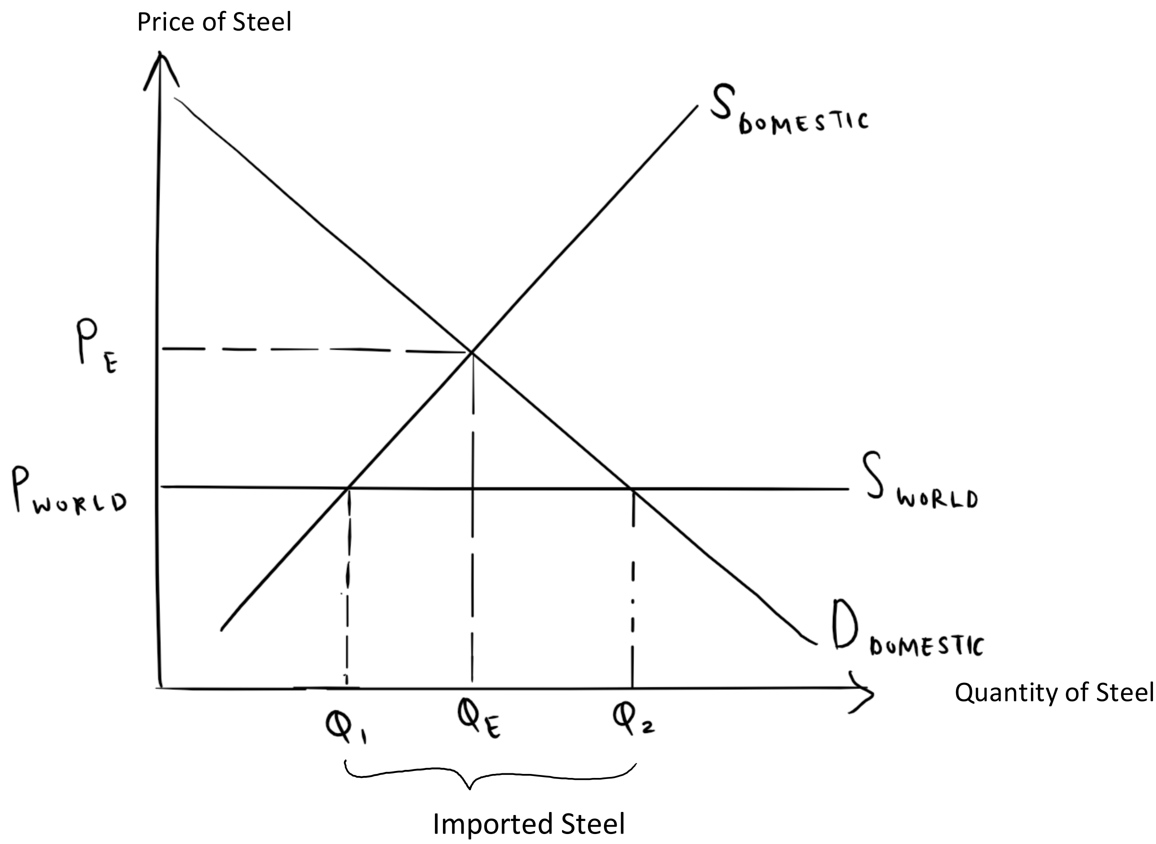
“This is one more piece of evidence in the worrisome trend that Trump seems to be turning over every rock and investigating each and every available tool available under US law to stop trade,” Mr Bown said.

Commentary on: Donald Trump's Steel Tariffs

The article presents President Donald Trump's decision to impose steel tariffs, limiting imported steel in a move towards protectionism for the United States. Reasons cited correcting the US trade deficit by boosting domestic employment and reviving the steel industry, in the interest of national economic security, despite growing concerns over hindering global growth.

In a closed economy, domestic price and quantity of steel lies at P_E and Q_E respectively. With trade, foreign suppliers supply steel at lower world prices of P_{WORLD}, with imports from Q_1-Q_2. However, the lower prices mean fewer US steel suppliers can afford to produce steel so domestic production stops at Q_1. This is illustrated in **Figure 1**.

Figure 1 Market for US Steel with Trade

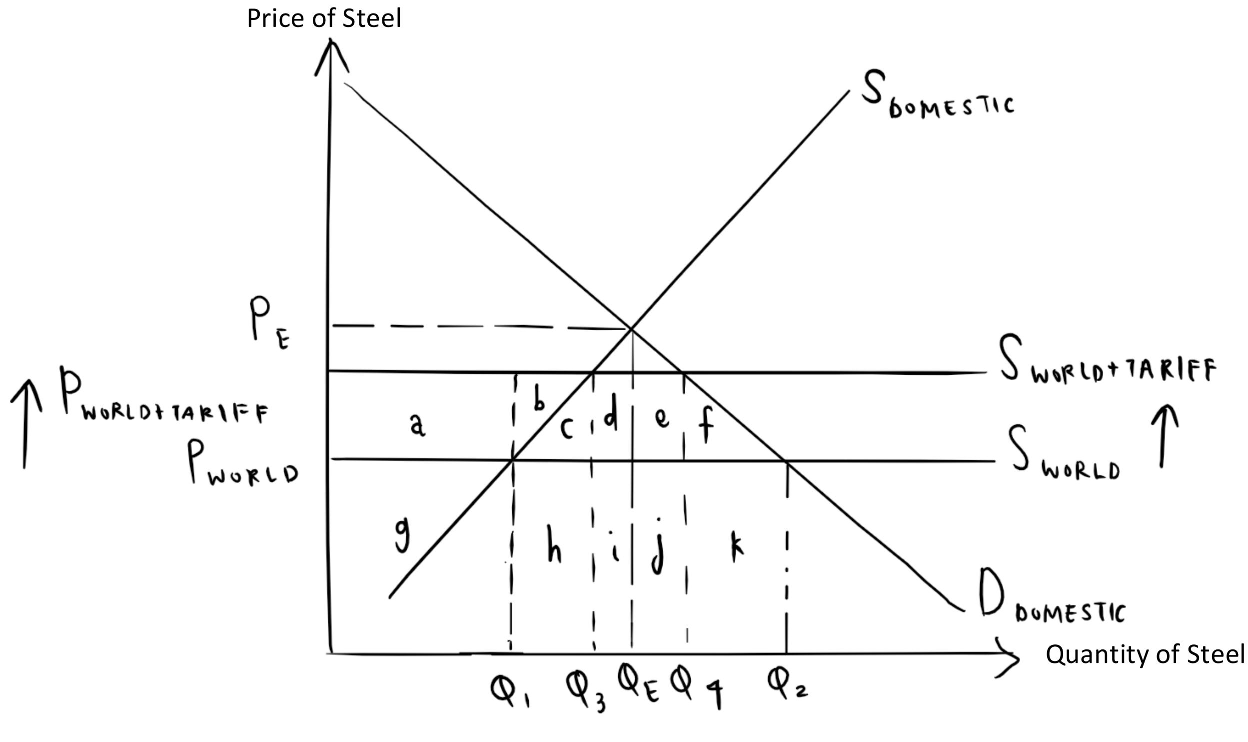


The US steel industry currently operates at 71% of its full capacity, with the identification of cheaper steel imports from China being one of the causes of the declining steel industry. Lower world prices make imports are more competitive, and demand for imported steel rises in the domestic market. Meanwhile, US steel exports become less attractive to other countries, causing a fall in demand for domestically-produced steel. This causes a trade deficit, believed to be the cause of the US economic woes. Additionally, structural unemployment also rises in the steel industry as demand for steel workers is a derived demand.

The argument for the imposition of a tariff, an import tax placed on a good produced abroad, stems from the protection of strategic industries. Steel is a strategic resource for the US economy and military. If diplomatic relations of the US were to grow strained causing a disruption in the supply of steel, it would place the US in a vulnerable, undesirable position where national economic security is threatened. Secondly, reviving domestic employment to fulfil the promises Trump has made in his campaign to his supporters is also another reason for protectionism.

The tariff adds to the cost of production for firms, in leftward shift of the supply curve, reflected in **Figure 2** where S_{WORLD} shifts to $S_{WORLD+TARIFF}$ and price of steel rises to $P_{WORLD+TARIFF}$.

Figure 2 Market for US Steel with Tariff



After the tariff, domestic producers can afford to produce more, represented by an increase in production from 0-Q_3 while receiving a greater revenue of **a+b+c+g+h**, which could be put into improving production of steel. The government is also able to collect import tax, shown in **d+e**, adding to government revenue.

Adversely, foreign production is limited to Q_3-Q_4, with an import revenue of only **i+j**. Furthermore, foreign producers are unable to enjoy the higher prices as the government collects the difference between P_{WORLD} and $_{PWORLD+TARIFF}$, as mentioned above. Consumers pay the higher price of $P_{WORLD+TARIFF}$, which causes quantity demanded of steel to fall to 0-Q_4 from the previously higher 0-Q_2. The tariff causes welfare loss to be experienced, shown by areas of **c+f**. Triangle **c** represents inefficiency of domestic producers producing at artificially higher prices of $P_{WORLD+TARIFF}$ while triangle **f** is the welfare loss caused by reduced consumption due to the fall in quantity demanded of steel.

The main problem of tariffs arises from the misallocation of resources as supply is shifted to domestic steel producers.

The Rust Belt in the US has long been one facing economic decline due to deindustrialization. The production processes and technologies employed by domestic steel producers would no longer be as advanced and efficient as foreign producers, hence incurring high costs of production which are passed on to the consumers as higher prices. Attempts to rejuvenate this sector of the economy may only result in short-term benefits but ultimately be delaying an inevitable decline in the steel industry due to the lack of relative productivity.

However, this could be solved by using tariff revenue collected to fund supply-side policies that can boost productivity of US steel producers, which should create an enduring expansion of the productive capacities. Such may include investment in research and development for efficient steel plants, or through implementing policies that support the steel industry, which had once been largely successful in the US.

Ultimately, the imposition of the steel tariff has both its benefits and limitations. The Trump administration’s prioritization of national interest has resulted in a relatively aggressive Foreign Policy which, coupled with recent proposed military spending in place of healthcare, could result in retaliation from other countries with the potential for escalation into a trade war and other political disruptions that would certainly impact the global economy. Withdrawing from the climate agreement in Paris has also allowed the US to revive the Rust Belt without restrictions, all in the favour of national welfare.