

THE ECONOMIC OUTLOOK GROUP



475 Wall Street
PRINCETON, NEW JERSEY 08540 Tel: 609 - 529 - 1300
www.economicoutlookgroup.com

ECONOMIC TALKING POINTS

Bernard Baumohl
Chief Global Economist

March 1, 2018

Client Bulletin:

Tariffs on Steel and Aluminum: A Blunder that Could End this Expansion.

While we are strictly non-partisan in our analysis, we have to be candid when the White House announces a policy that is utterly bereft of economic logic. So we'll just go ahead and say it. The Trump Administration just doesn't understand trade economics.

By imposing a 25% tariff on steel and 10% on aluminum, a policy the President announced this afternoon, he has set in motion a series of events that will fuel more inflation, force interest rates to leap higher, risk a trade war with other countries, and ultimately result in a net loss of at least 25,000 jobs. In short, the Administration just committed a policy blunder that places this entire economic expansion at grave risk.

If we are sounding too alarmist, consider this: We have far more workers in the US who make products that use steel and aluminum, than of workers who just produce these two commodities. In other words, every downstream industry that utilizes steel and aluminum to make products, such as motor vehicles, airlines, commercial buildings and residential units, will now be forced to recalculate how to cope with these additional costs.

History has shown that such tariffs end up doing far more harm than good. But

political leaders sometimes have an historical memory that goes right back to breakfast. So let's refresh their memory.

In 2002, President W. Bush ordered 30% tariffs on steel imports from around the world and got awful results. Not only did the import price of steel surge, it emboldened domestic producers to hike their price as well. The result was predictable: Companies that had relied on using less expensive steel were forced to layoff engineers, architects, construction workers and even shut down factories. About 200,000 people consequently lost their jobs, which represented \$4 billion in lost wages --- all to save far fewer workers in the steel industry.

Just how much damage Trump's tariffs on steel and aluminum will do to the economy depends on several factors. We do not yet know how long these tariffs are going to last, although President Trump noted that it would remain in effect "for a long time." Secondly, we can expect those targeted countries to retaliate against the US, thereby hurting US exporters too. Such shorted-sighted policy mistakes could easily lead to a trade war and finally bring this long and resilient business cycle to an end.

And for what purpose? Presumably it is to penalize China, South Korea and others countries that have dumped steel and aluminum into the US, meaning they were selling these products below their own cost of production.

But here's the irony. If you truly want to penalize foreign producers for dumping such products, then the smarter strategy is for US importers to actually buy as much of this dumped steel and aluminum as possible. Here's why. If China, for example, wants to sell steel at below cost, they are the ones ultimately losing money with each sale, not the U.S. The more the U.S. buys of these deeply discounted commodities, the greater the amount foreign producers lose on each transaction. In other words, by selling steel to us at a price point below where they can make a profit, China is actually subsidizing U.S. industrial production! Imagine that! They are providing the US with foreign aid! At some point, these Chinese firms will either go under, or they will plead for the Chinese government to rescue them. In the meantime, US manufacturers that rely on cheaper steel and aluminum can produce goods at a lower cost, saving American consumers money and raising their overall standard of living.

Unfortunately, with one stroke of a pen, President Trump has done the opposite, and for all the wrong reasons. Employment in the steel industry has been shrinking not so much because of dumping but mostly due to automation, higher productivity, and industry consolidation. Moreover, all the major US steel producers are profitable, with some enjoying the highest earnings in nearly a decade.

Again, we still lack many details of the plan. But make no mistake; the risk of significantly higher inflation is real. The Fed will then have to tighten monetary policy much more aggressively. Given this business cycle is already long in the tooth, what a shame it would be if all it took was this hugely ill-conceived tariff

policy that ends up tipping this economy into recession.

Let's hope the President quickly realizes the folly of his actions today and reverses course.

© Copyright 2018 All rights reserved.

The Economic Outlook Group, LLC