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Tariffs and the Party of Free Trade

The high cost of steel is an economic attack on America, by America
By David R. Breuhan

Not since the imposition of the Smoot-Hawley Tariff of 1930 has the government of the United States pursued such an unfortunate and self-destructive policy on trade. The list of punitive actions against our trading partners grows with each passing month. There are tariffs to protect the steel industry, tariffs to protect the lumber industry, and subsidies and other trade barriers to protect farmers.

The steel tariffs have caused the most damage to the broad economy and the manufacturing community as a whole. According to a February 2003 study by Joseph Francois and Laura Baughman called "The Unintended Consequences of the U.S. Steel Import Tariffs," 200,000 Americans lost their jobs due to higher steel prices during 2002. The study was done for the Consuming Industries Trade Action Coalition, using standard statistical methods. The authors found that one out of four of these job losses occurred in the metal-manufacturing, machinery and equipment, and transportation-equipment and parts sectors.

By any objective standard, the administration's effort to sustain the steel industry has backfired. The Bureau of Labor Statistics reports that seasonally adjusted manufacturing employment in March 2002 stood at 16,822,000. One year later, the preliminary number stands at 16,346,000. More than 475,000 jobs have disappeared-an astonishing loss of 1,304 jobs per day. Because of high barriers to entry in this sector, these jobs will never return. The March 2003, BLS data show total employment of 184,000 in the entire blast-furnace and basic steel-product industry.

The 200,000 jobs lost include parts manufacturers and commercial builders. Naturally, steel consuming industries suffer more than the beneficiaries of protection, but sometimes it seems protectionists can't count. In 1999, there were 12.8 million jobs in American steel-using industries and 226,000 workers in basic steel production.

A Self-Inflicted Wound

Some supporters of the tariffs have attempted to discredit the Francois/Baughman study. However, the data clearly demonstrate that there is something terribly wrong in the manufacturing sector of the economy. It is ironic that the Bush Administration's desire to punish foreign steel producers has probably hurt American manufacturers more than anyone overseas. Foreign steel firms are now shipping their product to China or Mexico, and then General Motors and Ford buy the parts from those countries, bypassing U.S. tariffs.

Some economists mistakenly believe that because of the many exemptions for foreign steel, these tariffs have little effect. They ignore the fact that the price of domestic steel has also increased more than 30% because of shortages and a lack of competition. In addition, there are no exemptions for domestic steel, which comprises almost 70% of all steel consumed in the United States. For example, the price of hot rolled steel jumped from $210 per net ton in December 2001, peaking at an astonishing $400 per net ton in July 2002. A total of 20,497,873 net tons of hot rolled steel sheet were shipped in 2001. The intermediate sector of the economy was overcharged well into the hundreds of millions of dollars last year, just for hot rolled alone.

Auto-parts makers have been unable to pass on these price increases in steel because their contracts with their customers mandate a price decrease every year. General Motors, Ford and Daimler Chrysler are telling their suppliers that they should open factories in Mexico or China if they want to keep their contracts. After all, there aren't any steel tariffs there to restrict their ability to compete. Unable to recapture the government-decreed steel price increase, the American manufacturing sector is slowly imploding.

Following the terrorist attacks of Sept. 11, the Dow Jones Industrial Average reached a low on Sept. 21, 2001, of 8,235.81. The market began to recover from this cyclical macroeconomic shock. The Dow reached 10,635.25 on March 19, 2002. The steel tariff took effect on March 20. Between March 2002 and May 2003, over $2 trillion of market capitalization vanished from the S&P 500.

Many of President Bush's critics mistakenly blame the 2001 tax cut for the economy's disappointing performance. Affording individuals greater control of their private property will never cause economic regression in a free market. Tariffs, on the other hand, raise the cost of inputs, and amount to an international tax on trade. Earnings drive markets and free trade supports higher earnings. If raw-material prices are higher, profits are lower and the stock market will adjust today for decreased earnings in the future.

While there were certainly cyclical reasons for the markets' downturn -- including the war on terror, the aftereffects of the Internet bubble, corporate fraud and poor earnings – tariffs represent a structural impediment to growth that markets cannot discount and that the passage of time and progress through the business cycle will not resolve.

Follow the Money

The steel industry has benefited from the tariffs. The industry has been allowed to consolidate under the protection of the government rather than the discipline of the free market, where consolidation would have been more rapid and sustainable while leaving steel consumers and the manufacturing sector intact.

Steel executives and union leaders point out that foreigners have violated international trade law, and that these tariffs are completely legal. The World Trade Organization has ruled otherwise. The industry must not be absolved of its responsibility to confront its own internal issues such as "legacy" costs of pension and health-care benefits, out-dated plant, property and equipment, and its chief competitor: non-unionized domestic mini-mills.

Steel officials have commented that consumers have not noticed a price increase on final goods and services. The reason: manufacturers have been forced to absorb all of the increased raw-material costs. A tariff is a tax and someone must pay it.

Although the economic rationale behind the steel-tariff decision was to afford protection to the American steel industry, political strategy may have actually forced the Bush Administration's hand. In order to get Fast Track Trade negotiating authority approved in the House, the Administration had to buy Congressional votes, guaranteeing that tariffs would be imposed. The vote cleared the floor, 215-214. As Karl Rove stated to a group of Republican donors in Dearborn, Michigan last Oct. 14, "Sometimes you have to take two steps forward and one step back when it comes to trade."

Adam Smith and David Ricardo would disagree. So would any sensible American voter.

Numbers Game

Based on 1999 figures, the ratio of steel-consuming jobs to steel-producing jobs was 68 to 1 in Michigan, 33 to 1 in Illinois and 16 to 1 in Pennsylvania. These three battleground states represent 59 electoral votes. Add New York, Massachusetts, and California (together worth 98 electoral votes), plus other states where steel-consuming industries are concentrated, and the Republicans will have much work to do in 2004. These six states amount to 58% of the total electoral votes needed to win.

With the endorsement of Richard Gephardt for President, the United Steelworkers have reminded the G.O.P. of an old truism: "You can't buy love." And what makes this entire situation very grave is the promise by the European Union to retaliate with 100% tariffs against selected American exports if the steel tariffs are not rescinded this fall. That would definitely decrease the fourth-quarter earnings and could negatively affect the equity markets.

The imposition of tariffs represents a failure of policymakers and diplomats to reach accords with our trading partners. It is one of the worst international actions a sovereign state can take against its neighbors. Tariffs make future agreements less likely, add to international tension, and increase economic nationalism, which was a root cause of the Second World War. The Bush Administration has reversed the evolutionary process of trade with actions that are both shortsighted and historically unsound.

The only hope for manufacturing is that a report from the International Trade Commission due to be published Sept. 20 will recommend rescinding the tariffs. Should that fail to happen, more manufacturing jobs will needlessly disappear -- along with more political support for the President.

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