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UNP-RC Discussion Paper Series 18-E-03

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Harmful Effects of Import Restrictions and Non-Market Measures*

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May 18, 2018

Abstract

The administration of U.S. President Donald Trump imposed import tariffs of 25% on steel and 10% on aluminum under Section 232 of the Trade Expansion Act of 1962 on the grounds that steel and aluminum imports are impairing national security by weakening the domestic industries and released a plan to slap a 25% tariff on Chinese products worth \$50 billion under Section 301 of the Trade Act of 1974 for what it sees as intellectual property infringement by China. The United States' unilateral actions are unacceptable under WTO rules, even though the existing WTO rules are deemed insufficient as rules governing multilateral trade activities including those involving China in terms of correcting distortions in the global market and protecting intellectual property rights. Trying to solve a bilateral trade conflict by power with no judge to referee is a recipe for an economic tailspin, prompting retaliation from the other party, causing a contraction in trade not only between the two conflicting parties but also across the world, resulting in a loss in global economic welfare. All trading countries, including the United States and China, should work to improve the functioning of the market mechanism by eliminating non-market measures and enhancing intellectual property protection under a set of multilateral trade rules, in order to prevent the United States from taking unilateral import restrictions and its trade partners, such as China, from taking retaliatory measures.

* This article is a revised version of “*Bei Yūnyu Seigen no Heigai* [Harmful Effects of Unilateral Import Restrictions by the United States]: Part 1” published in *Nihon Keizai Shimbun* on April 6, 2018 with some additional information and changes.

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1. Introduction

The administration of U.S. President Donald Trump imposed import tariffs of 25% on steel and 10% on aluminum under Section 232 of the Trade Expansion Act of 1962 on the grounds that steel and aluminum imports are impairing national security by weakening the domestic industries. The administration also released a plan to slap a 25% tariff on Chinese products worth \$50 billion under Section 301 of the Trade Act of 1974 for what it sees as intellectual property infringement by China, followed by an announcement of its intention to impose additional tariffs on \$100 billion of Chinese goods including high-tech products. China responded by imposing retaliatory tariffs of equivalent value on U.S. products. Trump's attempt to protect the domestic steel and aluminum industries from international competition could backfire, negatively affecting the U.S. economy and employment. In addition, such unilateral implementation of import restrictions outside the framework of the World Trade Organization (WTO) could put the global trade regime in jeopardy. Behind the tit-for-tat over trade is a gulf of perception between the two countries concerning measures the U.S. administration has been urging China to take to open its market and crack down on intellectual property infringement. In what follows, I would like to discuss the problematic nature of import restrictions and the future direction of trade policy in consideration of the peculiarities of the steel and aluminum industries and the status quo of intellectual property protection.

2. Propagation to other trade items and retaliation from trade partners

The history of steel import restrictions by the United States dates back to the 1960s. Because of their strong position in the market, U.S. steelmakers used to have significant power to control prices. In the early 1960s, it was quite easy to pass on any increase in costs onto prices, and thus raising employee wages was not difficult. However, on the other side of the same coin, they were beginning to lose competitive advantage, lagging behind their foreign rivals in investing in continuous casting facilities and technology development. This resulted in higher domestic steel prices and a boost in imports. Responding to calls from the domestic steel industry, the administration of President Lyndon Johnson had Japan and the European Community agree to "voluntarily restrict" U.S.-bound steel exports. More than half a century later, the United States has repeatedly implemented various measures to curb steel imports, including voluntary export restrictions on the part of trading partners, anti-dumping duties, the trigger price mechanism (TPM) designed to inhibit steel imports below set prices, and countervailing duties intended to neutralize the effects of subsidies. However, the import restrictions invoked on March 23, 2018 differ from those previously implemented safeguard measures in citing national security as the reason for their imposition.

As an internationally accepted exception, a WTO member may take "any action which it considers

necessary for the protection of its essential security interests.” However, the scope of the applicability of this exception is understood as being very limited. Indeed, action under the Section 232 of the Trade Expansion Act has been taken only in eight cases, all of which are oil-related, with import restrictions imposed in only five of them. A broad range of industries, including high-tech and scarce resources development, are perceived to be related to national security. Why did the United States pick only the steel and aluminum industries as being applicable to protection on the grounds of safeguarding national security? The question is all the more relevant given the fact that there are very few industries for which the entire production process is completed within a single country in today’s world where such processes are distributed globally with most industries integrated into global production networks. As far as judging from the U.S. Department of Commerce’s reports on the Section 232 investigations on the effects of steel and aluminum imports (2018), there is no convincing reason why only the steel and aluminum industries are regarded as having been exposed to and weakened by competition with imports and thereby threatening to impair national security. If increasing imports are causing a decline in the competitiveness of the domestic steel and aluminum industries and thereby threatening to impair national security, the same should apply—to quite a considerable extent—to many other goods and services, and other countries would use the same reasoning to justify the imposition of trade restrictions. As a result, unilateral import restrictions on the grounds of safeguarding national security would propagate to many other industries and other countries. It is a well-known fact that the Tariff Act of 1930, commonly known as the Smoot-Hawley Tariff Act, was introduced with the intention of protecting farmers in the Midwest but in no time became applicable to the industrial sector.

3. Impact on user industries and job losses

The latest import restrictions are aimed to ease international competitive pressure on the U.S. steel and aluminum industries, and not likely to have any effect in revitalizing the industries. As aforementioned, the U.S. steel industry has long been protected from international competitive pressure, but remains far from being revitalized today. In his study published in 1986, Princeton University Professor Gene Grossman showed that job losses in the U.S. steel industry have been attributable chiefly to structural changes—i.e., changes in technology, demand, resource allocation, etc.—while an increase in imports has had an lonely marginal impact. Meanwhile, a study conducted by Portland State University Professor Roger Ahlbrandt et al. (1997) showed that cost reductions and productivity improvement through the efficient use of technology and good management would be the only way to revitalize the steel industry. What Trump promised during campaign was to improve the job environment of the steel industry in the Rust Belt. If the easing of international competitive pressure is the sole purpose, the latest import restrictions will do more harm than good, resulting in higher domestic prices for steel and aluminum and causing a further delay in revitalization efforts.

Furthermore, other segments of the economy—i.e., those other than the steel and aluminum industries—will suffer significant negative effects. While higher steel and aluminum prices are good for producers, those using them as intermediate goods will inevitably suffer. Trump reportedly said that imposing import tariffs on washing machines would likely lead to more factories in the United States. In this case, U.S. consumers, those who will get the short end of the stick, would have no choice but to pay a higher price or give up on purchasing a new washing machine. However, steel and aluminum users are no ordinary consumers but rather manufacturers such as automakers. An increase in the prices of intermediate goods means higher marginal costs for user industries, eroding their competitiveness and reducing jobs. Some companies may move production bases to other countries to avoid higher costs of intermediate goods. Protecting the domestic steel and aluminum industries would put a greater burden and job losses on the part of the user industries, deteriorating the economic welfare of the United States. The impact of such negative effects will be more serious on companies exposed to higher competition and may prompt those in the user industries to call for similar import restrictions.

Distortions in domestic prices caused by import tariffs impact not only producers but also users. If reviving the domestic steel and aluminum industries is the policy goal, the U.S. administration should pursue policy measures that would impact only producers, such as those designed to encourage capital investment, promote research and development (R&D), provide training to workers, and enhance infrastructure in areas home to steel and aluminum makers to help improve productivity. The imposition of import tariffs, which would negatively affect user industries, is not an appropriate policy option.

4. Cycle of retaliation

The import restrictions imposed by the United States on the grounds of protecting national security aims not only to safeguard the domestic steel and aluminum industries but also to extract favorable terms in negotiating with its trade partners to open their markets and expand U.S. exports. We can see this from the fact that the United States excluded some trade partners—those poised to compromise—from the steel and aluminum tariffs.

We all know that balancing trade between two countries is contradictory to the multilateral trade regime and that a country's trade and current account balance with the rest of the world can be achieved by macroeconomic management that controls the balance between savings and investment (or between aggregate supply and demand) within the country. Despite all of this, the United States is demanding its trade partners to correct bilateral trade imbalances, probably as a negotiating tactic to wring greater concessions from its trade partners in opening their markets.

Beside the import restrictions under Section 232 of the Trade Expansion Act, the Trump administration also announced a plan to impose tariffs under Section 301 of the Trade Act of 1974 on 1,300 items of high-tech and other products from China, worth \$50 billion in total, in a move to punish the country for infringing intellectual property rights. Obviously, both measures are unilateral action by the United States and not acceptable under WTO rules. What lies behind this is its frustration with China, unable to see any tangible results after years of efforts to urge Beijing to open its market and take action to prevent intellectual property infringements.

The United States is the world's largest market. The tactic of negotiating trade deals to its advantage by threatening to close its huge market has not been without success. In the 1980s, the United States urged Japan, which was then running a significant bilateral trade surplus, to voluntarily restrain auto exports to, and expand semiconductor imports from, the United States by using Section 301 of the Trade Act as a negotiation tool. From fear of getting blocked out of the U.S. market, Japan conceded. However, as it turned out, those developments triggered momentum that led to the creation of the WTO and hence the prohibition of unilateral action. Having acceded to the WTO in 2001, China is entitled to enjoy the benefits of free trade, and its economy has expanded to the extent that it may soon overtake the United States. Taking advantage of where it stands today, China announced its intention to fight back against the United States, citing the relevant rules of the WTO. In retaliation for the U.S. restrictions on steel and aluminum imports, China imposed 15% tariffs on 120 items of U.S.-made products—including nuts and wine—worth \$1 billion, and 25% tariffs on eight additional items—such as pork and aluminum scraps—worth \$2 billion. Furthermore, in response to the U.S. imposition of 25% tariffs on the 1,300 made-in-China high-tech and other products worth \$50 billion, Beijing expressed its readiness to impose 25% tariffs on 106 items—mostly agricultural products such as soybeans, corn, wheat, and beef—worth \$50 billion. This prompted the Trump administration to announce a plan to raise tariffs on additional import items from China worth \$100 billion as a sanction for intellectual property infringements. If all of those tit-for-tat measures turn into reality, the trade friction between the two countries would go far beyond a squabble and inevitably escalate into a full-fledged trade war. In the past, the U.S. unilateral action under the Smoot-Hawley Tariff Act of 1930, which raises tariffs on numerous items, prompted its trade partners to do the same in retaliation, eventually resulting in the collapse of the world trade system. We must not repeat this tragic mistake.

5. Non-market measures and distortions in the global market

The steel and aluminum industries, which are subject to the import restrictions by the United States, have economies of scale unique to material industries, where supply capacity is a key determinant of competitiveness. As they stand today, they are characterized by the dominant presence of Chinese

companies, including state-owned enterprises (SOEs), which have rapidly expanded production capacity over the years to accounts for half of the total supply capacity across the world.

The Chinese steel industry's supply capacity jumped from 150 million tons in 2000 to 1.16 billion tons in 2016, keeping pace with the rapid growth of the economy. During the same period, the worldwide capacity for steel production increased by 1.3 billion tons, with Chinese companies accounting for three-quarters of the additional capacity. The increase in the supply capacity of the Chinese steel industry fulfilled the growing domestic demand during the high growth period. However, as the Chinese market became saturated due to a slowdown of the economy following the collapse of Lehman Brothers, Chinese steelmakers began to use their extra capacity to serve the global market. In 2016, China's steel exports totaled more than 100 million tons, exceeding the total demand in the United States (Figure 1).

The situation in the aluminum industry is similar to that of the steel industry. China's aluminum metal production capacity grew 10-fold from 4.3 million tons in 2001 to 43 million tons in 2016, accounting for more than half of the worldwide capacity of 75.5 million tons (Table 1).

The tremendous growth in Chinese exports attests to the fact that China has obtained free access to the global market by accessing the WTO. At the same time, however, it is also true that the remarkable expansion of China's supply capacity, which occurred in a very short period, has dampened steel and aluminum prices on the global market, causing friction between China and its trade partners. WTO statistics show that anti-dumping investigations on Chinese steel and other metals account for 20% of the global total.

Players in the Chinese steel industry include a significant number of SOEs under the supervision of provisional authorities along with those under the direct control of the central government such as Ansteel Group Corporation and China Baowu Steel Group Corporation. Likewise, the aluminum industry includes Aluminum Corporation of China (CHINALCO), an SOE under the central government, as well as those under the supervision of provincial authorities. Supported by central and local government subsidies, those SOEs are not subject to strict budgetary constraints and tend to stay on the market and maintain excess production capacity even when operating at a loss. This tendency is particularly conspicuous among small- and medium-sized SOEs under the supervision of local governments, according to a 2017 study by Gakushuin University Professor Mariko Watanabe. The presence of such non-market factors associated with SOEs could distort prices in the global market.

Although imports account for more than 30% of the total steel demand in the United States, imports from China represents less than 1% (Figure 2). Given that, it may be inappropriate to apply the WTO safeguard rules to steel imports from China, because the WTO safeguard provisions may be invoked only when a rapid increase in imports attributable to dumping practices and subsidies on the part of

exporting countries has caused or threatens to cause material injury to the competing domestic industry. However, there is no denying the possibility that global excess capacity has caused a slump in steel prices, subjecting the U.S. steel industry to significant competitive pressure generated by growing cheap imports from multiple countries. If the existing global excess capacity and market distortions are attributable to non-market factors associated with Chinese SOEs, the situation should be rectified.

The problem of excess capacity in the global steel industry has been subject to discussion at the OECD's Global Forum and taken up at a series of meetings of the Group of 20 (G20) economies. The U.S. Department of Commerce's report (2018) on the findings of the investigation for the import restrictions also points to the need to eliminate market-distorting subsidies and government support measures, foster a level playing field in the steel industry and ensure market-based outcomes, and encourage adjustment. Even if non-market measures in support of SOEs are actually causing an increase in production capacity and hence distorting the global market, the situation cannot be addressed under the existing international trade rules. The same problem could occur in other industries, not confined to the steel and aluminum industries.

The Trans-Pacific Partnership (TPP) agreement contained rules requiring SOEs to act "in accordance with commercial considerations," recognizing the possibility that the provision of unfair benefits to SOEs could undermine fair and open trade and investment activities. The United States was the driving force behind this.

It has been pointed out that the protection of intellectual property rights, which should be ensured by countries on the both sides of the trade, is not properly implemented in trade with China, which is growing in volume. With respect to the protection of industrial property, a series of rules have been set under existing international treaties and agreements such as the Paris Convention for the Protection of Industrial Property, the Berne Convention for the Protection of Literary and Artistic Works, and the WTO Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS Agreement). Among such rules are those designed to maintain an appropriate level of intellectual property rights protection, ensure the implementation of national and most-favored nation treatment, and prohibit non-competitive licensing, as well as those providing for border detention measures to prevent intellectual property rights infringements, and dispute settlement procedures comparable to those under the WTO. However, TPP negotiating parties reckoned that the existing rules were insufficient when it comes to the duration of patent protection, protection for data and drug-related intellectual property rights, trademark acquisition and the prevention of abuse thereof, the extension of copyright durations and rights protection, legal protection for geographical indications, and so forth. Thus, the protection of intellectual property rights became one of the focal issues in the TPP negotiation to make rules to address all of those issues. The United States again played an active role in the process but subsequently withdrew from the TPP.

6. Conclusion; Improving the functioning of the market mechanism under multilateral trade rules

The United States' unilateral action to impose import restrictions under Section 232 of the Trade Expansion Act and Section 301 of the Trade Act is unacceptable under WTO rules. Trying to solve a bilateral trade conflict by power with no judge to referee is a recipe for an economic tailspin, prompting retaliation from the other party, causing a contraction in trade not only between the two conflicting parties but also across the world, resulting in a loss in global economic welfare. We must prevent this from happening. However, the fact that the WTO has maintained the non-market economy status of China, the world's largest trading country in goods¹, can be seen as the origin of the U.S. move to restrict steel and aluminum imports on the grounds of safeguarding national security and some other items for the sake of protecting intellectual property rights. The existing WTO rules cannot be deemed sufficient as rules governing multilateral trade activities including those involving China in terms of correcting distortions in the global market and protecting intellectual property rights.

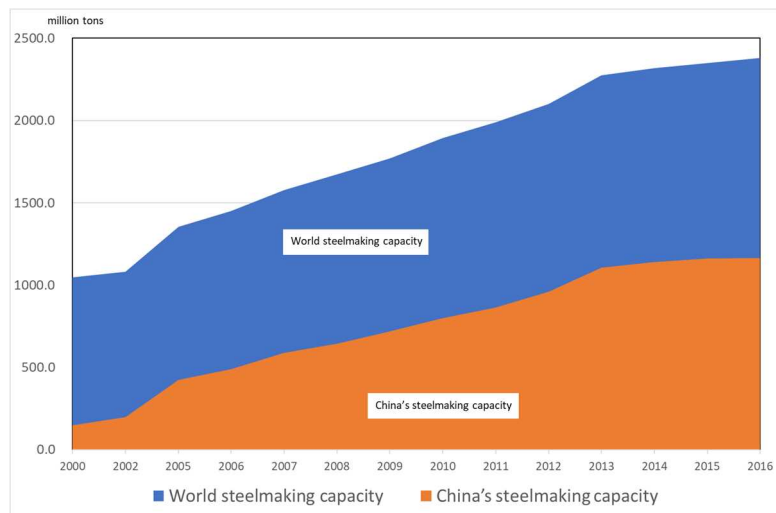
All trading countries, including the United States and China, should work to improve the functioning of the market mechanism by eliminating non-market measures and enhancing intellectual property protection under a set of multilateral trade rules. It is in this direction that we should pursue trade policy in order to prevent the United States from taking unilateral import restrictions and its trade partners, such as China, from taking retaliatory measures.

¹ According to the WTO, China's trade in goods with the rest of the world amounted to \$4.1 trillion in 2017, compared with \$3.95 trillion of the United States, \$2.61 trillion of Germany, \$1.37 trillion of Japan, and \$1.22 trillion of the Netherlands.

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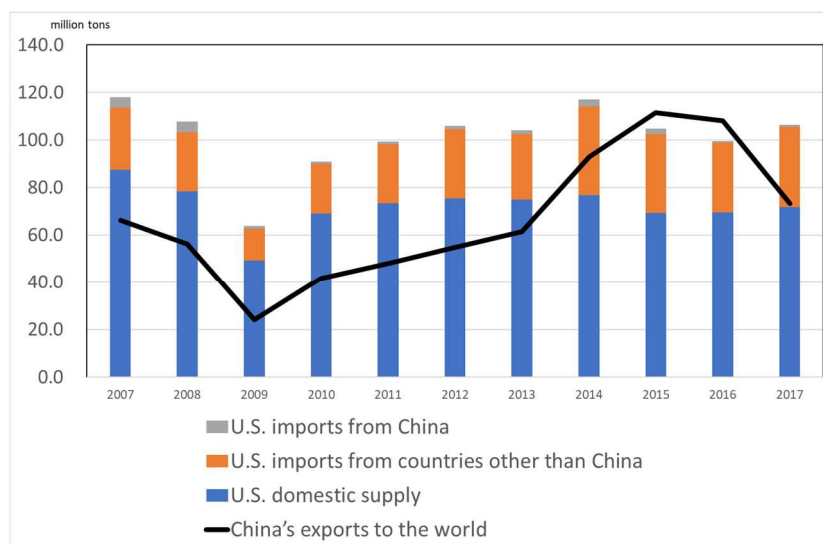
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Figure 1: Changes in the Steelmaking Capacity



Source: Created by the author based on data from the Organisation for Economic Co-operation and Development (OECD)'s "Capacity Developments in the World Steel Industry."

Figure 2: Supply and Demand in the U.S. Steel Market and Chinese Exports



Note: U.S. domestic supply = Domestic output – U.S. exports to the world

Sources: Created by the author based on the World Steel Association's "Steel Statistical Yearbook," the OECD's "Steelmaking Capacity," the U.S. Department of Commerce's "Steel Exports Report: China," the U.S. Census Bureau's "Imports of Steel Products," and the U.S. Department of Commerce's "The Effect of Imports of Steel on National Security."

Table 1: Aluminum Metal Production in the World

	Production capacity		Production
	2001	2016	2016
China	4,250	43,200	31,900
Russia	3,300	3,900	3,560
Canada	2,670	3,270	3,210
UAE		2,500	2,500
India		3,600	3,720
Australia	1,810	1,720	1,630
Norway	1,050	1,550	1,220
Bahrain		970	971
U.S.	4,370	2,000	941
Brazil	1,280	1,400	793
Global total	28,200	75,500	58,900

Note: In thousand tons.

Source: U.S. Geological Survey (USGC), “Mineral Commodity Summaries”