

CITY A.M.

Ramping up tariffs to spite Trump is economic self-harm

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It is not so much what Donald Trump did, but why he justified doing it, that has got trade experts and US allies worried over the past week.

In the grand scheme of things, the President's decision to impose tariffs of 25 per cent and 10 per cent on steel and aluminium is not an economic catastrophe.

Sure, it amounts to mild self-harm for the US economy – raising costs for downstream industries which, on net, could lead to 146,000 fewer jobs and less productivity.

But there are many ruinous economic policies imposed by governments around the world, and plenty of countries impose tariffs. The EU alone has over 12,500, which have precisely the same deleterious impacts.

No, it's Trump's claim that protection is needed for national security reasons that has really riled everyone up – especially EU leaders. Not only do they consider it nonsensical (Canada is the number one exporter of these goods to the US) and worry that Trump's use of this justification risks similar reasoning elsewhere in the world, but as the second biggest source of US imports of both products combined, Brussels wants to protect the economic interests of EU producers.

One can understand the grievance and sense of injustice. But so far the EU's petty producer-centric response risks making all the talk of a "trade war" a self-fulfilling prophecy.

Reacting to Trump's announcement, EU Commission president Jean-Claude Juncker said the EU could fight "stupid with stupid", targeting tariffs on US goods such as motorcycles, jeans, and bourbon whiskey – all goods with major producers in Republican areas.

The aim is to ramp up political pressure on Trump to abandon them. But this seems a foolish, dangerous approach, both economically and politically, living up to the stereotypical anti-American caricature of continental Europeans, and misjudging the President's resolve.

From a rational economic perspective, both the US administration and the EU should recognise that it is domestic consumers who ultimately bear the majority of the cost of tariffs through

higher prices. If one focuses on this, rather than producer concerns, one realises that a trade war entails both sides harming their own economies to try to get the other to back down.

The economic conclusion is that the optimal response to a trade partner imposing import tariffs is to keep your own trade free, unless the threat of tariffs can be harnessed to deliver free trade both ways.

In this case, Trump has made clear he is intent on steel and aluminium tariffs come what may, as confirmed by his Treasury secretary Steve Mnuchin and the resignation of his economic adviser Gary Cohn.

If correct, highly politicised EU tariffs on US goods will overwhelmingly hurt EU consumers, for no upside. In fact, if they then become permanent, they would lower economic productivity by insulating European producers from US competition.

This would be bad enough on its own, but it actually risks much worse escalation. Trump has already said that if the EU goes ahead with its retaliatory tariffs, the US government will ramp up tariffs on European cars. A tariff here, a tariff there. We are, it seems, just one or two badly judged diplomatic economic policy decisions from a full-blown trade war.

At this juncture, the question of “who started it?” will be irrelevant. We would all suffer.

Whereas in actual wars in the past we attempted to blockade other countries from importing the goods and services they wanted and needed, with rising tariffs we would be economically blockading ourselves.

This would amount to destroying value for the sake of showing displeasure at what, on the face of it, was an initial relatively minor decision in an economic sense.

Though it sounds counterintuitive, and will stick in the craw of those who think that Trump is undermining the rules-based trading system, the better path is for the EU to choose to de-escalate the situation by not retaliating.

Yes, work with allies to propose multilateral action to deal with anti-competitive practices in the steel industry in particular, but do not rile a protectionist President further with politically motivated tariffs.

Indeed, if the EU really believes in the case for free trade, it cannot ignore the logic of its own arguments. Rather than fighting producer-centric tariffs with producer-centric tariffs, it should instead put EU consumers first.

This would mean both abandoning planned retaliation, and also reconsidering the host of barriers imposed through its own Common External Tariff, which serve to raise prices and undermine the dynamism of the EU economy.

Given the self-harming nature of trade wars, the best thing the EU can do is lead by example, and choose peace.

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