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Trump's new trade idea may be a bigger mistake than tariffs

Bob Ryan

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President Donald Trump again backed off a serious trade threat on Monday by extending exemptions for steel and aluminium tariffs for six US allies, giving the countries 30 days to work out a deal with the US over trade imbalances for the metals.

But trade experts say the Trump administration's stated goal for the negotiations may be even worse news for the global economy.

In Monday's statement, the Trump administration insisted that any country wanting an exemption from the metal tariffs must agree to a quota system.

"In all of these negotiations, the Administration is focused on quotas that will restrain imports, prevent transshipment, and protect the national security," the statement said.

The Trump administration has already secured an agreement with South Korea that would exempt it in exchange for a quota system allowing South Korea to export about 70% of its average steel volume sent to the US over the past three years.

Peter Navarro, the director of the White House National Trade Council, confirmed the quota goal during a talk on Tuesday hosted by the American Iron and Steel Institute and the Steel Manufacturers Association.

"The guiding principle of this administration, from the president down to his team, is that any country or entity like the European Union, which is exempt from the tariffs, will have a quota and other restrictions," Navarro said, according to Politico.

Quotas hurt just as much as tariffs

Quotas, also known as voluntary export restrictions, may sound like a softer approach than tariffs. But experts say they may cause more problems than they solve.

On a basic level, a quota still presents economic issues similar to tariffs. It means that the supply of a good from overseas decreases and the price subsequently rises. That drives up costs for producers in the US and prices for US consumers.

Plus, a quota misses one benefit of a tariff: tax revenue for the US.

In fact, a quota could result in tax revenue for a foreign government if it sells export rights to companies, said Dmitry Grozoubinski, an expert at the International Centre for Trade and Sustainable Development.

“While fairly regressive and counterproductive, tariffs are still ultimately a form of tax in that they raise government revenue which can be reinvested,” Grozoubinski tweeted Monday. “A VER has all the downsides of a tariff, without any of the revenue.”

So a quota has all the economic downside of a tariff without the budgetary upside.

Problems beyond economics

Beyond the revenue problem, a quota system opens the door for corruption, said Chad Bown, a senior fellow at the Peterson Institute for International Economics.

Bown said that to control the amount of a metal exported to the US and abide by the quota, a country typically gives licenses to some businesses to sell to the US.

And since the US is a lucrative market for exporters, businesses tend to do whatever they can to get those licenses.

“That breeds corruption,” Bown said. “Because if I’m a government bureaucrat, I’m the one who gets to decide who gets the licence – well, now someone is willing to pay me something for that because it is so valuable. This is why the United States has for decades discouraged the use of quotas in countries around the world.”

The US is not expected to allocate licenses under a quota system, though the details of its agreements with other countries are unclear.

A third problem with the quota idea is that it’s likely to break international trade rules laid out by the World Trade Organisation, according to Simon Lester, a trade-policy analyst at the Cato Institute.

VERs “were a problem in the 1980s and were prohibited in Article 11.1(b) of the WTO’s Safeguards Agreement,” Lester told Business Insider in an email Tuesday. “By agreeing to them, the US and the other country are pretty clearly violating WTO rules.”

Lester alluded to perhaps the most famous example of the use of VERs: the US’s agreement with Japan to limit imports of cars in the 1980s, an effort to protect struggling US automakers from more efficient Japanese producers.

Most studies of that quota have found that the boost helped in the short term but was ultimately ineffective at best. The decade of negotiations eventually led Japan to leave bilateral trade negotiations with the US and work on a multilateral basis through the WTO.