INVESTOR'S BUSINESS DAILY®

Big Steel's Dilemma: Trade Restriction Cure Is Worse Than The Disease

Daniel R. Pearson

May 17, 2016

The world is awash in surplus steel.

This is due primarily to an eightfold expansion over 15 years in China's output. Prices are low worldwide. Some U.S. steel firms have been losing money and are seeking additional restrictions on steel imports.

There is no doubt that Chinese policies have contributed directly to the low-price conditions. However, limiting imports is the wrong policy response for the United States.

Trying to cure the low-price "disease" by restricting trade would not succeed in restoring health to U.S. steel producers, yet that "cure" would impose huge costs on the much-larger downstream manufacturing sector that uses steel as an input. Steel import restrictions serve to harm the overall U.S. economy rather than help it.

U.S. steel producers are accustomed to the up-and-down cyclicality of the steel market, but are justifiably aggrieved by today's relatively weak prices. Global steel output has doubled from roughly 800 million metric tons (MMT) in 2,000 to over 1,600 MMT in 2015. (Last year China produced 804 MMT, half the world's total.)

U.S. output actually declined about 20% over that same time, slipping from 101 MMT to only 79 MMT last year. The U.S. is a substantial net importer of steel; purchases from other countries generally range from 20 to 40 MMT.

The traditional response by the steel industry to troublesome import competition has been to seek trade restrictions. These usually take the form of anti-dumping (AD) measures aimed at the exports of foreign firms, or countervailing duties (CVD) that seek to offset subsidies provided by foreign governments.

The U.S. already has implemented 149 AD or CVD measures against steel imports. With domestic producers still suffering despite so much protection, it seems implausible to expect that a few more restrictions would alleviate their financial stress.

However, more import barriers undoubtedly would add to the substantial harm that AD/CVD measures already are doing to value-added manufacturers that require steel as an input. In essence, steel protectionism has made the U.S. a high-priced island in a sea of low-priced steel.

U.S. prices still are not high enough to make much of the U.S. steel industry profitable. They are high enough, though, to present a substantial competitive disadvantage to steel-using American firms that compete against imports of manufactured goods from countries that have access to world-price steel.

Economists have understood for over 100 years that countries imposing import restrictions do more damage to their own economies than any damage that might be done to exporting countries.

The relative sizes of the steel-producing and steel-consuming sectors make clear why the United States loses when it imposes import restraints.

Data from the Department of Commerce indicate that "primary metal manufacturing" (NAICS 331), which includes production of steel and all other metals, accounted for about $60 billion of value added to the U.S. economy in 2014.

Downstream manufacturers that use steel as an input generated value-added of $990 billion, more than 16 times higher. Employment in primary metal manufacture was slightly less than 400,000, while for steel-using industries, it was 6.5 million, also 16 times more. While the steel industry is important, it is much less economically significant than the manufacturing that uses steel.

What should be done instead of using trade remedies?

U.S. policymakers should take advantage of fundamental economics. China's decision to export steel for less than it is worth has the effect of transferring wealth from China to the U.S. As a practical matter, the best way to encourage China to downsize and restructure its industry would be to reframe the debate by communicating the following message to the Chinese government:

"Thank you for transferring so much wealth from China to the United States by selling low-priced steel! Please continue doing it! Is China willing to sign 10-year contracts guaranteeing that wealth transfers will continue?"

By radically changing the terms of the discussion, this approach has a decent prospect for getting the Chinese to rethink what they are doing.

The current U.S. approach is to complain to them about how much their exports are hurting American steel producers. Instead, that argument should be turned on its head by thanking them for helping to strengthen the competitiveness of the much larger U.S. steel-consuming sector.

Daniel R. Pearson is a Senior Fellow of Trade Policy Studies at the Cato Institute