

FEBRUARY 2019



## The Great Tariff Debate

A look at mainstream coverage of tariffs (and biases), the history of Section 232 and China's role in all of it.

# Tariff Impact Studies Rely on Questionable Assumptions

Consultants internally often pose a question to one another – do you want a client who knows he doesn't know something, or would you rather have a client that doesn't know what he doesn't know?

It turns out that phrase came from the famed economist, John Kenneth Galbraith, who actually used it to describe forecasters: “We have two classes of forecasters: Those who don't know ... and those who don't know they don't know.”

Most consultants (and forecasters) would likely argue one would rather have the former – it's better to work with someone who knows he doesn't know something than one who doesn't know what he doesn't know.

The same argument applies to trade and tariffs.

The mass media and much of the public has embraced the notion that tariffs are bad and continued “free trade” — with China — is good.


But is it? Does the mainstream press know what it doesn't know?

We will come to this question shortly — but first, the conventional thinking.

## Koch Companies Trade Study

According to a recent [Koch Companies study on trade](#), the U.S. economy will see some very negative impacts on the economy as a result of President Donald Trump's trade war, including:

- Macroeconomic losses, which project declining GDP of 1.78% and a long-term impact in 2030 of 1.25%
- Household financial losses of \$2,357 per household in 2019, which compound to \$17,276 in spending power over a 12-year time frame (2018-2030) in the form of lower wages, higher prices and lower investment returns
- Increased unemployment
- Production losses by 2030 modeled as a loss of 1% against the baseline for agricultural and services sectors and a manufacturing production decline of 2.5% from baseline



All of the aforementioned appear as reasonable conclusions one might make based on a standard methodology using the GTAP model and database, which ironically was the very same model used by the Department of Commerce to come up with the rationale for imposing Section 232 tariffs in the first place! Other countries have also used the GTAP model to formulate trade policies.

The Koch Companies' study stands in good company. Multiple additional governmental and pay-to-play studies have come out arguing similarly against tariffs. Here are just a few:

- [The Dallas Fed](#) trade study (as in the Federal Reserve Bank of Dallas)
- [This study](#) from Trade Partnership Worldwide
- The Tax Foundation [ran a study](#)
- [Even competitor sites to MetalMiner](#), such as CRU, have modeled the impact of tariffs on the wider economy

So why in the world should we question these studies?

Because the studies don't tell the whole story.

### **Media Bias, Not Fake News**

Forget about fake news: legitimate studies have confirmed anti-tariff media bias.

[A study conducted in 2005](#) — after the Bush steel tariffs of 2002 — sought to test a prediction that, “newspapers will devote more space to the costs of tariffs than to their benefits...” The study sampled 123 stories on trade from The New York Times and 177 stories from the Wall Street Journal (the stories ran during the Bush steel tariffs of 2002 from Jan. 1 through Sept. 10). The WSJ also showed a “slant” toward free trade as measured by more sentences criticizing tariffs than supporting them, compared to The New York Times, according to the study methodology.

Not surprisingly, the results showed newspapers covered the “costs” of steel tariffs more than the benefits and the authors concluded the results suggest “that mass media will weaken the power of special-interest lobbies relative to unorganized interests.”

Simply put, one should expect more anti-tariff media coverage than pro-tariff coverage.

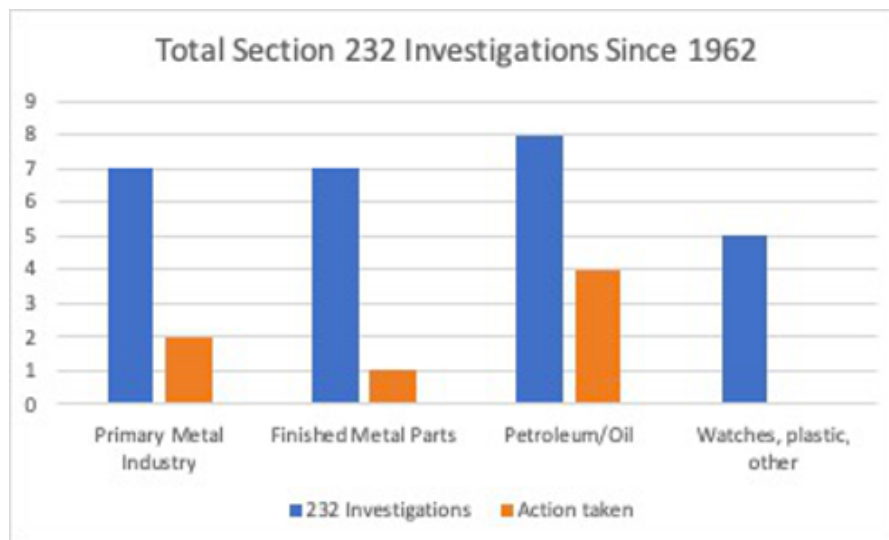
Before we dive further into the studies, let's re-examine the history of Section 232 and what cases have resulted in presidential trade action.

# Section 232 History Since 1962

The Bush tariffs of 2002 came as a result of a Section 201, as opposed to a Section 232 investigation. The Trade Act of 1974 covers Section 201 investigations, whereas Section 232 derives its authority as part of the Trade Expansion Act of 1962, based on national security grounds.

MetalMiner conducted an analysis of every single Section 232 case initiated since the passage of the Trade Expansion Act of 1962. The results suggest market observers need to dig into the details further to see why various presidents have taken action on imports of particular commodities, as well as what types of action they have taken.

Section 232 has been invoked 26 times.



Source: MetalMiner analysis of ITC data

Of the seven times in which a primary metal industry initiated a Section 232 investigation, in only one case, this most recent, did the president determine action was necessary to adjust imports. However, in one of the cases, President Ronald Reagan agreed to update the National Defense Stockpile.

Of the seven times in which a derivative metal industry (nuts, bolts, bearings, parts) initiated a Section 232 investigation, in no cases did the president conclude action was necessary to adjust imports. However, in one case, for metal cutting and metal forming machine tools, Reagan deferred a decision on Section 232 and instead sought voluntary agreements with foreign suppliers; indeed, one went into effect for a period of five years and was extended for two additional years.

In all other cases, the only industry that received Section 232 relief has been petroleum or oil. Now that the U.S. has achieved energy independence, MetalMiner suspects the U.S. will not see a case made under Section 232 for this commodity so long as the U.S. remains energy independent.

The U.S., however, is not steel independent, meaning the U.S. does require some level of imports to satisfy domestic demand.

Historical [analysis suggests](#) the U.S. has filed about the same number of anti-dumping cases today as it did in the late 1950s-1970s. The difference today, though, comes down to the imposition of duties; far more are implemented today than during that earlier time period.

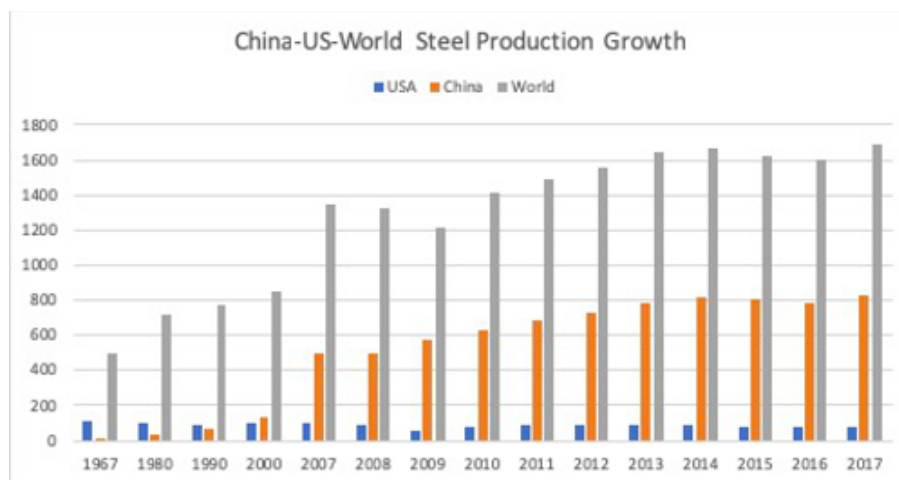
Logically, as tariffs have steadily declined, imports have grown, while today the number of products targeted for anti-dumping measures has declined since the 1980s.

### What Has Changed and Why Should Anyone Care?

In a word: China.

In 1960, China [produced a total of 18.5 million tons of steel](#), whereas the U.S. produced about 6 million tons. Incidentally, the [price of a ton of steel in 1962 was \\$144/ton](#) — or \$1,180/ton in today's dollars!

It wasn't until 1996 when China first produced 100 million metric tons of steel. And the real growth happened after China ascended to the WTO in 2001, growing steel production from 128.5 million metric tons in 2000 to nearly 495 million metric tons in 2007.

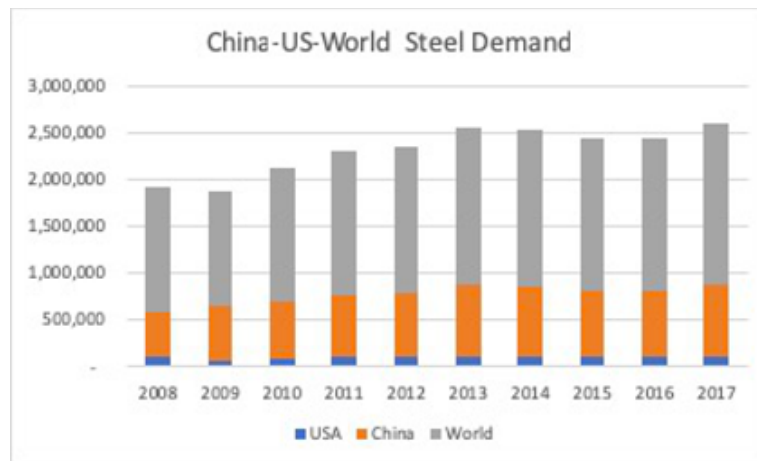


Source: MetalMiner analysis of World Steel Association data

Obviously, as China's economy began to grow, steel demand also grew. Any market observer would also expect production to increase to support economic growth.

Perhaps the more interesting statistic to examine is production against demand. By looking at the production figures above, one might assume that demand also steadily increased since 2007.

But did it?



Source: MetalMiner analysis of World Steel Association data

In a word: no.

China's demand peaked in 2013 at 772 million tons, declined and then reached 767 million tons in 2017, whereas China produced 779 million tons in 2013 (a little higher than demand). But in 2017 China produced 831.7 million tons for a surplus of 64.7 million tons.

2018 statistics show China produced [more steel than any year in its history](#) — 923 million metric tons, according to Reuters, against a demand projection that is at best flat to slightly up from 2017, based on a MetalMiner analysis. Assuming demand of 780 million tons, that would suggest a surplus of over 140 million metric tons.

U.S. demand and production, in contrast, appears paltry. It should come as no surprise that the Trump administration has taken significant steps to shore up the domestic industry against Chinese imports.

The only study that takes into consideration these factors, such as actual demand and actual supply, involved the [original Department of Commerce studies on Section 232](#).

# 2002 Bush Section 201 Steel Tariffs

All of this background analysis brings us to the heart of the current debate: are the tariffs “bad” for the economy and manufacturing?

The only trade study published on tariffs that measures actual impact — as opposed to using models to support claims — sheds some light.

As previously [reported by MetalMiner](#), a 2003 study used primary research with 419 steel-consuming companies, as opposed to econometric modeling. At the time, this represented fully 22% of all steel purchased by companies in the U.S. That [study concluded](#) “overall employment of steel-consuming industries general fell or remained flat in 2002-03” compared with the previous two years, but that productivity and wages increased over the three-year period.

Moreover, the study noted a \$30.4 million GDP loss — not nothing, but insignificant against the total. Perhaps most ironically among steel-consuming companies, “overall sales and profits increased, while capital investment fell, for most steel-consuming industries in 2002-03 – the period after the implementation of the safeguard measures.”

Not all results were positive.

Half of industry respondents reported higher steel prices and 43% said that they could not pass those costs onto their customers. Some reported that producers broke contracts. Finally, 32% of respondents saw higher lead times, while 46% of respondents noted difficulties in obtaining materials.

## Which Brings Us Back to the “Model” Studies...

The use of models remains inherently flawed because most models require the use of forward-looking data and assumptions.

The Coalition for a Prosperous America [conducted a trade study](#) that generated different results from the Koch study primarily by taking into consideration actual baseline GDP and total employment data, and CBO forecasts for GDP and employment (the CBO is considered by policy wonks to be the most neutral of all economic reporting government entities). That study also factored in industry plans and announcements from the steel industry and used the Regional Economic Modeling Inc’s (REMI) model, which is used widely by think tanks, state and local governments, etc.

# Other Government Research Debunks Broader Negative Tariff Impact Claims

A Congressional Research Service (CRS) analysis points to “negative” impacts from the tariffs on steel and aluminum. [That analysis](#), however, suggests a much narrower range of impacts from higher prices of steel and aluminum to lower imports of those same commodities.

The study also claims input costs will rise for downstream manufacturers. Certainly, prices have risen with the imposition of the tariffs. However, nobody has conducted research to determine if manufacturers could pass down costs and/or if their profits were lower, higher or about the same as prior to the tariffs.

In other words, have the higher prices actually impacted GDP and employment data?

The CRS study suggests the two biggest variables to consider relates to downstream prices and availability of imports, which will depend upon the range of product and country exclusions and the degree to which other countries retaliate.

Regardless, the ISM Report on Manufacturing released in December, which also relies upon primary research with downstream manufacturers, reported: “Despite U.S. tariffs on foreign steel and aluminum, prices for those key materials have declined, executives said.”

Those price declines mirror current commodity market conditions in which the overall bull market appears to have run out of steam. MetalMiner’s long-term outlook for both commodities and industrial metals shifted from bullish to bearish back in December 2018 and January 2019, respectively.

It’s easy to glob onto the mainstream trade war discourse and assume the widely circulated studies must serve as the whole truth. The truth, however, requires the media and the public to acknowledge “real” anti-tariff media bias, the actual overcapacity conditions that led to the imposition of Section 232 in the first place, and the impacts measured post-tariff as reported by those that actually, as opposed to theoretically, felt the impact (e.g. downstream manufacturing organizations).

The “war” on trade requires all of us to dig deeper and perhaps seek to learn what we don’t know.