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Trump's Travesty of Protectionism



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Trump's series of threats this week was a one-two punch. First, he threatened to impose national security tariffs on steel and aluminum, primarily against Canada and Mexico (along with Korea and Japan). Then, he suggested an alternative: He would exempt these countries *if* they agree to certain U.S. demands.

But these demands make so little economic sense that they should be viewed as an exercise in what academia used to call power politics. Or in Trump's world, Us versus Them, a zero-sum game in which he has to show that America wins, they lose.

It won't work. Trump's diplomatic ploy with Mexico is to say that he'll be willing to exempt them from the steel and aluminum tariffs *if* they agree to (1) build the wall that he promised to make them build, and (2) give other special favors to the United States. He can then go to American voters and say, "See, we won; Mexico lost."

This is unlikely to elicit a Mexican surrender. Its president already has said that building a wall makes no sense, and cancelled the planned diplomatic visit to Washington last week. Giving in to Trump's election promise to American voters (or more to the point, indulging in his own ego trip about the wall) would be political suicide. Trump would crow that he made Mexico bow to his bidding.

Matters aren't much better in Canada. While some Pennsylvania and Ohio steel companies probably will try to make Trump look good by hiring back a few hundred workers if and when the tariffs are announced, Canada and other suppliers would have to be laid off. Canadian resentment already has been building up for decades, ever since the auto agreement of the 1960s and '70s that favored U.S. suppliers.

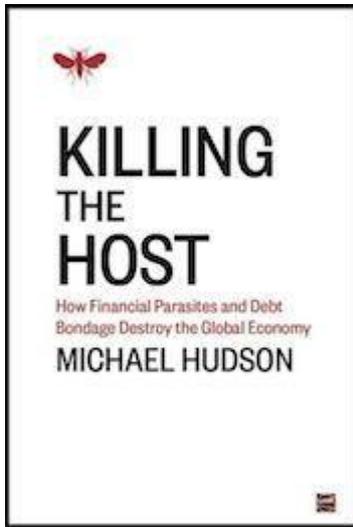
But the real economic problem comes from within the United States itself. If new steel workers are hired, they may be laid off in a few months. Most important is the bigger economy-wide picture: The Chamber of Commerce and other groups have calculated that the loss of jobs in steel- and aluminum-using industries will far outnumber the new hiring of steel and aluminum workers.

NPR on Wednesday had a maker of beer kegs explain that if the cost of steel goes up, he can't afford to match the prices of foreign keg manufacturers who buy their raw materials cheaper – and do NOT have tariffs raised on higher manufactures.

There are many good arguments for protectionism. These arguments are in fact much better than the free-trade patter talk used to indoctrinate college economics students. Of all the branches of today's mainstream economics, free-trade theory is the most unrealistic. If *it were* realistic, Britain, the United States and Germany never would have risen to world industrial powers. (I review the fallacies of free-trade theory in [*Trade, Development and Foreign Debt*](#).)

Economic history provides a long and excellent successful pedigree of good arguments for protective tariffs. Britain created its empire by protectionism, stifling manufactures in the United States as long as it pursued free trade. After the Civil War ended, America built up its industry and agriculture by protectionism, as did Germany and France. (I discuss the strategy in [*America's Protectionist Takeoff: 1815-1914*](#).)

But as each of these nations became world leaders, they sought to pull up the ladder and prevent other countries from protecting their own industry and agriculture. So they changed to “free trade imperialism.” The aim of industrial leaders is to convince other



countries not to regulate or plan their own markets, but to let the United States engineer an asymmetrical trade policy whose aim is to make other countries dependent on its food exports and monopoly exports, while opening their markets to U.S. companies.

Since the 1920s the protectionist economies that came to support free trade have rewritten of history to white out how they got rich. The strategy of protectionism has been forgotten. Trump’s so-called protective tariffs against steel and aluminum are the antithesis to every principle of protectionism. That is why they are so self-destructive.

A really nationalistic trade strategy is to buy raw materials cheaply, and sell finished manufactured goods at a high value-added price.

The idea of industrial protectionism, from British free trade in the 19th century to U.S. trade strategy in the 20th century, was to obtain raw materials in the cheapest places – by making other countries compete to supply them – and protect your high-technology manufactures where the major capital investment, profits and monopoly rents are.

Trump is doing the reverse: He’s increasing the cost of steel and aluminum raw materials inputs. This will squeeze the profits of industrial companies using steel and aluminum – without protecting their markets.

In fact, other countries are now able to legally raise their tariffs to protect their highest-technology sectors that might be most threatened by U.S. exports. Harley Davidson motorcycles have been singled out. They also can block U.S. monopoly exports, such as bourbon and Levi blue jeans, or pharmaceuticals. Or, China can block whatever U.S. technology it decides it wants to compete with.

Trump's tariff threats caused short-term aluminum prices to jump by 40 percent, and steel prices by about 33 percent. This raises the price of these materials to U.S. manufacturers, squeezing their profits. Foreign manufacturers will not have their materials prices increased, and so can out-compete with U.S. steel- or aluminum-using rivals. The global oversupply in fact may make the price of steel and aluminum decline in foreign markets. So foreign industry will gain a cost advantage.

On top of that, foreign countries can legally raise tariffs in their own markets – for whatever industries they deem will best gain from this advantage.

Trump's tariffs will not induce new capital investment in steel or aluminum

America's logic behind protective tariffs after the Civil War ended the Southern free-trade policies was that tariff protection would create a price umbrella enabling U.S. manufacturers to invest in plant and equipment. Britain already had made these sunk costs, so the United States had to include the cost of capital in its revenue.

That's how America built up its steel industry, chemical industry and other manufacturing industry.

But no steel or aluminum company is likely to invest more or hire more U.S. labor as a result of higher tariff revenues. These companies may raise their prices, but neither investment nor trickle-down effects are likely.

For one thing, aluminum is made out of electricity, and America is a high-cost producer. Alcan – America's largest supplier – has a rip-off deal with Iceland getting electricity almost for nothing.

For steel, it takes a long time to build a modern steel mill. No company will do this without an assured market. Trump's tariff increases do not guarantee that.

America's policy of breaking international agreements (we're the "indispensable nation")

Few companies, labor groups or banks in New York City have been willing to trust Mr. Trump in recent years. He should have called his book "The Art of BREAKING THE deal." That's how he made his money. He would sign an agreement with suppliers to his hotels or other buildings, and then offer only 80 cents (or less) on the dollar. He'd tell them, in effect: "You want to sue? That will cost you \$50,000 to get into court, and then wait three or four years, by which time we'll have made enough money to pay you on the cheap."

Bank lenders had as much trouble getting paid as did Trump's hapless suppliers. He made his fortune this way – so successfully that he seems to believe that he can use the same strategy in international diplomacy, just as he's threatening to break the Iran agreement.

Will this work? Or are foreign economies coming to view the United States as “not agreement-capable”? In fact, will U.S. companies themselves believe that agreements signed today will still be honored tomorrow?

Trump’s national security ploy to bypass Congressional authority over trade policy

This is not the first time the United States has raised tariffs unilaterally. George W. Bush did it. And my 1979 book, *Global Fracture*, describes U.S. protectionism in the 1970s against other countries. America did it again and again.

But Trump has introduced some new twists. First of all, former U.S. protectionism had Congressional backing. But Trump has bypassed Congress, no doubt aware that steel-using and aluminum-using industries can mobilize Congressional support against Trump.

So Trump has used the one play available to the Executive Branch: the National Security umbrella. In a great mind-expansion exercise he claims that it would be a loss of national security to depend on neighboring Canada, Mexico, or allies such as South Korea and Japan for steel and aluminum. If he can convince a kangaroo trade court, this loophole is indeed allowed under WTO rules (GATT Article XXI). The idea was to apply to times of war or other great crisis. But U.S. steel and aluminum production has been steady for over a decade, and there seems to be no military or economic crisis affecting national security.

Suppose Trump gets away with it. Other countries can play this “national security” game. *Any* economic activity can be deemed national security, because every economy is an overall system, with every given part affecting all the others. So Trump has opened the door for overall asymmetrical jockeying for position. The most likely arena may be high-technology and military-related sectors.

Back in the 1980s this was called “Uncle Sucker” patter talk – acting as if the United States was the exploited party, not the exploiting actor in international trade and investment. Ultimately at issue is how much policy asymmetry the rest of the world is willing to tolerate. Can the United States still push other countries around as it has done for so many years? How far can America push its one-sided agreements before other countries break away?

Each foreign country threatened with loss of steel or aluminum exports has a more high-tech industry that it would like to protect against U.S. competition. The response is likely to be asymmetrical.

And here at home, how long will higher manufacturing industries back Mr. Trump and his policy that makes a travesty of “smart” protectionism?