

## Promoting national security through steel tariffs?

Patrik T. Hultberg, Kalamazoo College

[Patrik.Hultberg@kzoo.edu](mailto:Patrik.Hultberg@kzoo.edu)

Author:

**Patrik Hultberg, PhD**, is Professor of Economics and Coordinator of Educational Effectiveness at Kalamazoo College, as well as Visiting Professor at Sungkyunkwan University, South Korea, where he teaches in the International Summer Semester program. Professor Hultberg has taught both economics and business courses for many years, often using case studies to promote student learning. He is a member of the Editorial Board for the CASE Journal, and has written several cases related to both business and economics. Professor Hultberg's research interests include international economics, higher education, and instructional design.

A concise case from the *International Journal of Instructional Cases*

[www.ijicases.com](http://www.ijicases.com)

Copyright 2018: International Journal of Instructional Cases

This case is only intended for use by the purchaser within a pedagogic setting and sharing with other third parties, or republication, is expressly forbidden.

## Promoting national security through steel tariffs?

Patrik T. Hultberg, Kalamazoo College

Less than two weeks after the release of a U.S. Department of Commerce report that indicated that steel imports posed a threat to U.S. national security, President Trump announced that he had “decided to impose punishing tariffs on imported steel [...] in a major escalation of his trade offensive” and that U.S. steel-producers “will have protection for the first time in a long while, and you’re going to regrow your industries,” as reported by the Washington Post (March 1, 2018).

The announcement followed weeks of intense debate inside the White House due to sharp disagreement between the President’s two top economic advisors. Gary Cohn, chief economic advisor to the President, consistently argued against the use of tariffs and for a free-trade agenda, while Peter Navarro, Director of the White House National Trade Council, argued for tariffs. Mr. Cohn’s free trade position had been contrasted to President Trump’s campaign speeches that promised tariffs against countries that “cheated” or engaged in “unfair” trade practices, often mentioning China as an example. In fact, the campaign rhetoric was much closer to ideas promoted by Dr. Navarro who was known as a trade deficit hawk that had long advocated for trade restrictions on national security grounds against, in particular, China.

Clearly Dr. Navarro had finally prevailed during the internal discussions and Mr. Cohn resigned shortly after the tariff announcement. But the negative response of the markets to Mr. Cohn’s departure, as indicated by a fall in the U.S. dollar and stock futures, showed that not everyone agreed with President Trump’s decision.

### Background

Under section 232 of the Trade Expansion Act of 1962, the Secretary of Commerce has the authority to examine the impact of imports on the national security of the United States. The task involves monitoring domestic production for its ability to provide national security, as well as monitoring the impact of foreign competition on economic welfare of domestic industries. Section 232 thus defines national security very broadly, including

“...[to] give considerations to domestic production needed for projected national defense requirements, the capacity of domestic industries to meet such requirements, existing and anticipated availabilities of the human resources,

products, raw materials, and other supplies and services essential to the national defense, the requirements of growth of such industries and such supplies and services including the investment, exploration, and development necessary to assure such growth, and the importation of goods in terms of their quantities, availabilities, character, and use as those affect such industries and the capacity of the United States to meet national security requirements.”

On February 16, 2018, the U.S. Department of Commerce reported on its investigation into the impact on U.S. national security from imports of steel mill products. The report concluded that imports of steel posed a threat to U.S. national security due to the weakness of the domestic industry relative to global excess capacity. The report noted that the United States was the world’s largest importer of steel. It also determined that the global excess capacity in steel production was driven mostly by China, the world’s largest producer and exporter of steel. In fact, the report found that at this point China’s excess capacity was greater than total U.S. steel-making capacity.

In its discussion of the current state of the U.S. steel-making industry, the report laid out a number of findings, including the following: (1) imports of finished steel products is consistently over 30 percent of U.S. consumption; (2) in 2016, U.S. steel imports were almost four times the amount of U.S. exports of steel; (3) imports have contributed to plant closures as well as the reduction of steel industry employment by 35 percent since 1998. The report noted that U.S. steel producers’ costs are higher than the costs of production in other nations due to “higher taxes, healthcare, environmental, and other regulatory expenses.”

In response to these findings, the Commerce Department concluded that there was a threat to the long-term viability of the U.S. steel-making industry and therefore national security. In order to achieve long-term viability of the U.S. steel-making industry, the report argued that domestic steel production must increase its capacity utilization rate from its current 73% to 80% (see Exhibit 1). To achieve this, the main recommendation was a global tariff of at least 24% on all steel imports from all countries. The report noted that if any country was excluded from import restrictions, then tariffs on all remaining nations must be raised further. For example, if Canada and Europe were excluded then tariffs on remaining nations would have to rise to 53%.

### **National Security**

The security of a nation is a public good due to non-excludability and non-rivalry. That is, it is virtually impossible to exclude someone from benefiting from provided national security and one individual’s security does not detract from others’ levels of security. It is therefore unlikely

that private companies will be able to supply national security and there is a need for government intervention. Steel, however, is by itself a “private” good since consumers of steel can easily exclude others from using their steel and steel used to produce, say, a truck cannot be used to produce anything else.

The national security argument for steel, in particular, is that the metal is an important input into the production of goods that are crucial in times of conflict, such as vehicles, energy production, and weaponry. Thus a nation that imports most of its steel is vulnerable to the possibility of a trade embargo. Consequently a sufficient amount of steel may need to be produced domestically or, alternatively, by allies to prepare for the possibility of conflict. To achieve the minimum requirement of domestic steel production, the government may have to adopt policies, possibly including trade policies, which can ensure the security of the nation.

In fact, the Commerce Department’s report states that the U.S. Department of Defense (DoD) “has a large and ongoing need for a range of steel products that are used in fabricating weapons and related systems for the nation’s defense.” In a memorandum to Commerce Secretary Wilbur Ross, Secretary of Defense Jim Mattis wrote the following:

“DoD believes that the systematic use of unfair trade practices to intentionally erode our innovation and manufacturing industrial base poses a risk to our national security. As such, DoD concurs with the Department of Commerce's conclusion that imports of foreign steel [sic] and aluminum based on unfair trading practices impair the national security. As noted in both Section 232 reports, however, the U.S. military requirements for steel and aluminum [sic] each only represent about three percent of U.S. Production [sic]. Therefore, DoD does not believe that the findings in the reports impact the ability of DoD programs to acquire the steel or aluminum necessary to meet national defense requirements.”

On March 8, 2018 President Trump made the steel tariffs official by signing the “Presidential Proclamation on Adjusting Imports of Steel into the United States,” in which he concurred with the Department of Commerce and decided to “adjust the imports of steel articles by imposing a 25 percent ad valorem tariff on steel articles [...] imported from all countries except Canada and Mexico.” The President noted that his action would “help our domestic steel industry to revive idled facilities, open closed mills, preserve necessary skills by hiring new steel workers, and maintain or increase production, which will reduce our Nation’s need to rely on foreign producers for steel and ensure that domestic producers can continue to supply all the steel

necessary for critical industries and national defense.” See Exhibit 2 for the list of the top nations from which the United States imported steel.

### **The Response**

Immediately following President Trump’s announcement of tariffs on foreign produced steel the European Union issued a strong response. This reaction was significant since the European Union (all member countries combined) was the second largest exporter of steel to the United States. The EU announced that it would challenge “national security” tariffs through the formal World Trade Organization (WTO) dispute resolution mechanism. In addition, the EU promised to retaliate immediately by putting 25% tariffs on several U.S. products such as Harley Davidson motorcycles, blue jeans, and bourbon.

Shortly afterwards China also responded to the steel tariffs by announcing 25% tariffs on scrap aluminum and pork products, as well as a 15% tariff on fresh and dried fruit, nuts, and sparkling wine. In total 120 U.S. products were affected with a value of the tariffs estimated at \$3 billion, matching the U.S. tariffs impact on Chinese exports. Several other nations also indicated that they would respond in kind to the steel tariffs.

In response to the pushback the Trump administration issued several exemptions, announcing that from March 23 to April 30, the following countries were exempt from the steel tariffs: Canada, Mexico, Australia, Argentina, South Korea, Brazil, and all member countries of the European Union. This was a temporary respite to allow for negotiations and all countries would once again be subject to tariffs on May 1, 2018. Notably, China was not exempted.

After China’s adoption of retaliatory tariffs on 120 U.S. products, President Trump responded instantly by announcing, but not implementing, a 25% tax on close to 1,300 Chinese goods (valued at around \$50 billion) from the aerospace, machinery and medical industries. The next day, China warned of another \$50 billion worth of tariffs on U.S. products, including aircrafts and automobiles. Shortly afterwards, President Trump tweeted a call for tariffs covering an additional \$100 billion of Chinese goods.

The threat and adoption of retaliatory tariffs by trading partners and allies highlighted the potential costs associated with the President’s trade policy. The back and forth between President Trump and Chinese President Xi Jinping brought the possibility of a trade war into sharp relief. It suddenly seemed less clear whether steel tariffs would raise national security or instead augment the threat of global conflicts.

**Exhibit 1: Import Levels and U.S. Steel Mill Capacity Utilization Rates**

Steel Market Snapshot (millions of metric tons)	2011-2016 Average	2017 Annualized
Total Demand for Steel in U.S. (production + Imports – Exports)	105.5	107.3
U.S. Annual Capacity	114.4	113.3
U.S. Annual Production	84.6	81.9
Capacity Utilization Rate (percentage)	74.0 %	72.3 %
Imports and Exports (millions of metric tons)		
Imports of Steel to U.S.	31.8	36.0
Exports of Steel from U.S.	10.8	10.1
Import Penetration (percentage)	30.1 %	33.8 %

Table reproduced from Figure 1 (p. 7) in *The Effect of Imports of Steel on the National Security*, U.S. Department of Commerce, January 11, 2018.

Note: Import penetration measures value of imports as a percentage of total domestic demand.

**Exhibit 2: Top steel exporters to the United States, 2017**

Country	% of total steel imports	% change 2011-17, annualized	Country	% of total steel imports	% change 2011-17, annualized
1. Canada	(16.1%)	[+5%]	7. Japan	(5.0%)	[-2%]
2. Brazil	(13.0%)	[+66%]	8. Germany	(3.8%)	[+40%]
3. South Korea	(10.2%)	[+42%]	9. Taiwan	(3.5%)	[+113%]
4. Mexico	(9.0%)	[+24%]	10. India	(2.4%)	[+16%]
5. Russia	(8.7%)	[+146%]	11. China	(2.2%)	[-31%]
6. Turkey	(6.3%)	[+238%]	12. Vietnam	(2.0%)	[+506%]

Table reproduced from Figure 2 (p. 28) in *The Effect of Imports of Steel on the National Security*, U.S. Department of Commerce, January 11, 2018.

Note: The percentage of total steel imports from the European Union approximated 14.7% in 2017.

**Sources:**

<https://www.commerce.gov/news/press-releases/2018/02/secretary-ross-releases-steel-and-aluminum-232-reports-coordination> (accessed March 28, 2018).

<https://www.commerce.gov/news/fact-sheets/2017/04/fact-sheet-section-232-investigations-effect-imports-national-security> (accessed March 28, 2018).

[https://www.washingtonpost.com/news/business/wp/2018/03/01/white-house-planning-major-announcement-thursday-on-steel-and-aluminum-imports/?utm\\_term=.cbe059e10afd](https://www.washingtonpost.com/news/business/wp/2018/03/01/white-house-planning-major-announcement-thursday-on-steel-and-aluminum-imports/?utm_term=.cbe059e10afd) (accessed April 2, 2018).

[https://www.commerce.gov/sites/commerce.gov/files/the\\_effect\\_of\\_imports\\_of\\_steel\\_on\\_the\\_national\\_security\\_-\\_with\\_redactions\\_-\\_20180111.pdf](https://www.commerce.gov/sites/commerce.gov/files/the_effect_of_imports_of_steel_on_the_national_security_-_with_redactions_-_20180111.pdf) (accessed March 28, 2018).

<https://www.bis.doc.gov/index.php/forms-documents/section-232-investigations/86-section-232-booklet/file> (accessed April 7, 2018).

<https://www.whitehouse.gov/presidential-actions/presidential-proclamation-adjusting-imports-steel-united-states/> (accessed April 1, 2018).

[https://www.washingtonpost.com/news/monkey-cage/wp/2018/03/09/europe-is-pushing-back-against-trumps-steel-and-aluminum-tariffs-heres-how/?utm\\_term=.ad036f4462d6](https://www.washingtonpost.com/news/monkey-cage/wp/2018/03/09/europe-is-pushing-back-against-trumps-steel-and-aluminum-tariffs-heres-how/?utm_term=.ad036f4462d6) (accessed April 9, 2018).

<http://money.cnn.com/2018/04/08/news/economy/trump-china-us-tariffs-trade-timeline/index.html> (accessed April 9, 2018).

<https://www.cbp.gov/trade/programs-administration/entry-summary/232-tariffs-aluminum-and-steel> (accessed April 8, 2018).

[https://www.commerce.gov/sites/commerce.gov/files/department\\_of\\_defense\\_memo\\_response\\_to\\_steel\\_and\\_aluminum\\_policy\\_recommendations.pdf](https://www.commerce.gov/sites/commerce.gov/files/department_of_defense_memo_response_to_steel_and_aluminum_policy_recommendations.pdf) (accessed May 19, 2018).