International Economics IA

U.S. Imposes 266% Duty on Some Chinese Steel Imports

Duties, which affect six other countries, intended to punish dumping to improperly gain market share

An employee is seen through a coil of cold-rolled full hard steel at the Indian unit of ArcelorMittal, in Khopoli, Maharashtra, India. PHOTO: BLOOMBERG NEWS

By John W. Miller and William Mauldin

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18 COMMENTS

The Department of Commerce Tuesday imposed preliminary duties on imports of cold-rolled steel, used to make auto parts, appliances and shipping containers, from seven countries including China, whose steelmakers were slapped with a massive tariff.

The duties, set at 265.79% for Chinese steelmakers, will be imposed within the next week but must still be confirmed in a final determination scheduled for this summer.

They are meant to punish dumping, or selling below cost. to improperly gain market share. Chinese officials have denied the practice.

After enduring one of their worst downturns ever, American steelmakers are now counting on tariff protection to help ride out a weak market. A slowdown in the steel-heavy oil-and-gas industries combined with a boom in Chinese exports has deflated steel prices around the world.

The benchmark hot-rolled coil index fell 35% in 2015 to under $400 per ton, contributing to a $1.5 billion loss at U.S. Steel Corp., and an almost $8 billion loss at ArcelorMittal, the world's biggest steelmaker, which has big operations in the U.S. Both those companies have had to lay off U.S. workers and were behind petitions to impose protective import tariffs on a range of steel products, including cold-rolled steel.

Lakshmi Mittal, CEO and controlling owner of Arcelormittal, in a recent interview said he was counting on tariff protection to help save his U.S. mills, heavily concentrated in northern Indiana. Tariffs, Mr. Mittal said, "will help prices." The Chinese steel industry lost $10 billion last year, he added. "That proves they're dumping." Chinese officials have denied dumping.

But can tariffs really save the American steel industry?

Analysts say trade protection will prop up prices, but can't be expected to save beleaguered companies or improve market demand, especially in the oil and gas segment.

"There'll be a short-term benefit," said John Packard of Steel Market Update. "However, in the long run, the U.S. mills are always going to want more tariffs, and it's questionable how much more [protection] they can get." The U.S. already has anti-dumping duties in place on 19 categories of Chinese steel. And the U.S. needs some imports because U.S. demand—regularly over 110 million tons—is far higher than the U.S.'s annual production of around 80 million tons.

Although China is only the seventh biggest exporter of steel to the U.S., behind Canada, Brazil, Russia, Mexico, South Korea and Turkey, Chinese steelmakers have received the most attention because they have the ability to disrupt the U.S. market. Their prices tend to be 20% to 50% lower than anybody else's, say steel traders. And because the volumes of its exports are so massive, Chinese steel is ending up everywhere. China last year exported more steel—100.4 million tons—than any other country except Japan produced.

The other countries affected by the duties are Brazil, India, Japan, Korea, Russia and the U.K.

Besides the fates of the individual companies, the tariff debate is landing in a campaign season where trade looms as a potentially major issue.

The campaign season and the rise of Donald Trump are renewing focus on the U.S. trade deficit with China, which averaged $1 billion a day in 2015. Mr. Trump has said he would impose large tariffs on Beijing, alarming U.S. officials and industry leaders who back free trade.

The Obama administration has been discussing steel production with China, which pledged to trim output by up to 150 million metric tons over five years. Chinese Premier Li Keqiang told U.S. Treasury Secretary Jacob Lew this week in Beijing the country would press ahead with economic overhauls to shrink the steel industry.

Industry officials and labor groups say China’s planned cuts amount to just a fraction of overcapacity and don’t go nearly far enough. "Talk and dialogue must not be a substitute for action as addressing the root cause is urgent,” said United Steelworkers President Leo Gerard.

Write to John W. Miller at john.miller@wsj.com and William Mauldin at

william.mauldin@wsj.com

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International Economics Commentary

The chosen article explains US government's decision to impose a 266% tariff or import duty on cold-rolled steel to protect the domestic steel market and eradicate China's dumping practices of "selling below cost to improperly gain market share".

The tariff is imposed to "ride out" the "weak" US steel market, which suffered from lower international demand and increased Chinese exports. Demand for steel shifts leftwards from D to D1 and the supply curve S shifts rightwards to S1, creating excess supply ab at the initial equilibrium price Pe and "deflating steel prices around the world" to Pe1.

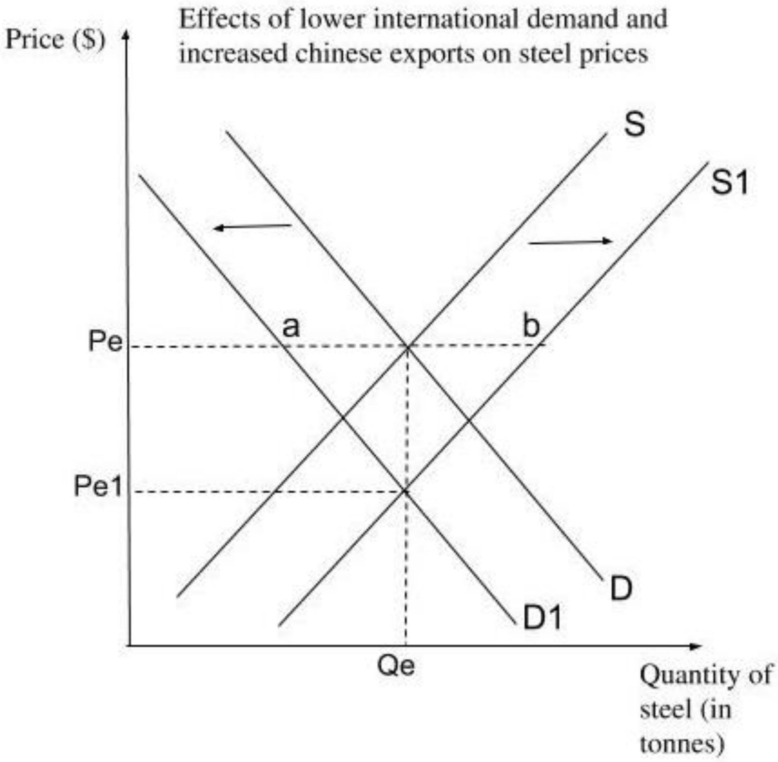

Diagram 1

The price fall has generated losses for domestic firms such as U.S. Steel Corp. and Arcelor Mittal of approximately \$1.5 billion and \$8 billion, increasing unemployment as the firms "lay off US workers" to cut costs. Thereby, the government has taken protectionist measures and imposed a 266% tariff.

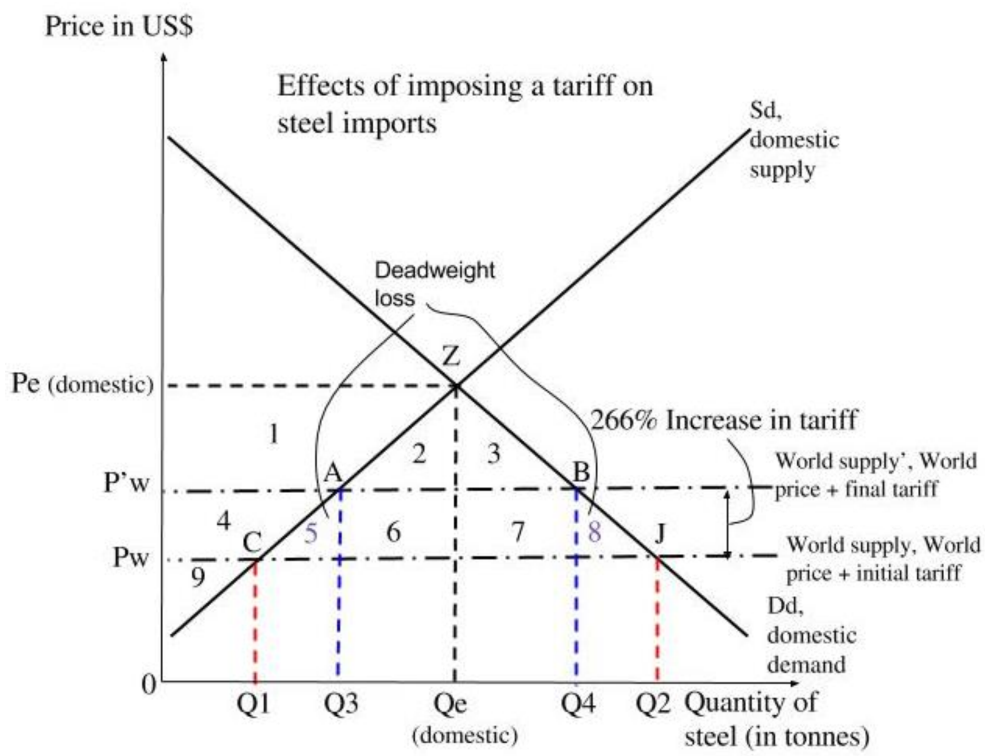

Diagram 2

Initially as the world price is Pw, domestic producers are forced to sell at Pw to remain competitive. As fewer producers are willing and able to supply at this price, the quantity supplied is Q1. Domestic consumption is Q2 and the excess quantity demanded, Q1Q2, is fulfilled mainly through Chinese steel imports.

The import duty increases world price for domestic importers by 266%, reducing consumption to Q4 and stimulating quantity supplied to Q3 at P'w, causing a fall in imports to Q3Q4. This has varying effects on stakeholders. American consumers have a surplus loss of 4,5,6,7,8, while producer surplus increases by 4. With 6 and 7 being tariff revenues for the government, the deadweight loss due to the tariff is 5 and 8, where 5 represents wasted resources from higher-cost production and 8 represents lost consumer gains.

Domestic steelmakers are protected as import prices are artificially inflated to make domestic prices appear cheaper. The expanding market size helps American steelmakers increase their profits and growth, encouraging them to reinvest their profits to promote efficiency and competitiveness in the international market. They also create employment opportunities for American workers, increasing disposable income and thus spending to stimulate aggregate demand and economic growth. Lastly, not only does the government earn tariff revenues that it can allocate to improve productivity in the steel industry, it also "punish[es] dumping" and reduces the US trade deficit "which averaged $1 billion a day in 2015".

However, steel imports are used to manufacture various appliances in the US, thereby increasing production costs for these import-dependent producers as the tariff is imposed. The inelastic demand for steel-imports catalyses unemployment as producers balance increasing costs by downsizing the most flexible factor of production- labour, creating a opportunity cost that the tariff could destroy more jobs than it creates. Import led inflation also occurs as firms raise their prices to cover the increased importing costs. Ultimately, consumers suffer from higher prices coupled with a limited choice of products, which constraints demand and thus output in the economy.

John Packard from Steel Market Update questions the sustainability of this solution arguing that the tariff only proposes "a short-term benefit", as it is simply a monetary disincentive that poses no quantitative limitations on importers. Imports may rise eventually despite the tariff. Also, while the protected steelmakers escape the international competition shortly, the industry is alienated from foreign technological developments and may have to sustain retaliation abroad in the long-term.

The article states that 30 million tons of imports are an annual necessity due to the exceeding domestic demand. A quota can be imposed instead, where total supply is constrained to the domestic supply plus 30 million tons of imports, making imports irresponsive to domestic demand changes, unlike in tariffs, and protecting domestic suppliers from international competitors. The outcome is more predictable compared to tariffs, leading to higher foreign exchange savings and increased domestic production. However, revenues typically earned by the US government through tariffs are earned by foreign exporters instead, creating a larger deadweight loss than tariffs by the amount of the tariff revenues.

Therefore, as supported by John Packard, protectionist measures are short-term solutions that breed consumption and production inefficiencies. Nonetheless, the 266% hefty duty on Chinese steel imports preserves employment in the US steel industry, eradicating a crucial threat for the government of losing its income tax base, and most importantly, punishes China's dumping practices. The protectionist measure has both advantages and negative consequences for the American economy, illustrating that there are opportunity costs in every economic decision.

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