The looming trade war over America's steel tariffs may yet be averted thanks largely to an expected surge in global steel prices

ON NOVEMBER 11th the World Trade Organisation (WTO) ruled definitively that America's so-called "safeguard" steel tariffs were illegal. The first response from the White House was defiant, but by mid-week it became clear that the Bush administration was in two minds about how to proceed. If it did not relent, Europe's response would be to slap retaliatory duties on $2.2 billion of products ranging from motor boats and sun glasses to textiles and orange juice. Its choice of targets is designed partly to serve Europe's own domestic interests by avoiding areas where it relies on American produce and, secondarily, to hurt producers in ways likely to do maximum damage to George Bush in next year's presidential election (see article).

The administration has not reaped the benefits it expected from the introduction of tariffs in March.
2002. The Institute for International Economics (IIE) in Washington, DC, calculates that the cost to steel users so far has been about $600m in lost profits from higher prices and 26,000 lost jobs. That dwarfs the benefit to American steel firms, which the IIE reckons has been only $240m, mostly from a 3.3% rise in average steel prices, with some 5,000 jobs saved. (America's International Trade Commission, which argued for the tariffs, disagrees about the price effect, saying they have raised prices by only 0.94%.)

The president has a number of options. Scrap the tariffs, and hope that the net benefits of trade will somehow tally with the electoral arithmetic. Defy the WTO and face retaliation from the European Union and seven other countries. Or find a third way that placates both the domestic steel industry and foreign steel exporters. One possibility is to reduce tariff rates and increase exemptions. Another option is more devious: eliminate the tariffs but keep some of the protection they offer by changing America's anti-dumping rules. Firms now subject both to safeguard tariffs and anti-dumping duties would instead simply face higher anti-dumping duties. Anti-dumping duties are levied retroactively. The money collected would even go to America's steel industry. The impact on European producers would be severe. Corus, an Anglo-Dutch group, says it would mean an anti-dumping duty of 50%.

The main argument of steel consumers is that they should not be denied cheaper foreign steel at a time when, for instance, Detroit's car industry is under intolerable pressure from Japanese, European and South Korean competitors. The companies that stamp out parts for cars from flat steel fear that continued upward pressure on their input prices will simply accelerate the trend for carmakers to seek more supplies of basic metal parts from distant, cheap-labour countries such as China.

Steel crazy after all these years

Those who want the tariffs to stay in place argue that the steel industry has been consolidating very effectively in recent years and that it deserves further protection to allow it to carry on its rationalisation and introduction of more-flexible labour practices. Wilbur Ross, the chief executive of International Steel Group (ISG), is an entrepreneur who has moved aggressively into steel by buying bankrupt companies and distressed assets. ISG has snapped up failing firms such as LTV, Acme and Bethlehem Steel. The latter was particularly burdened with pension and health-care costs for retired workers. Multiple rounds of job cuts had left it with seven pensioners per employee. With these costs offloaded on to a federal body, Mr Ross went on to transform the economics of steelmaking in traditional integrated plants, thanks to radical deals with the United Steel Workers of America. The union was surprisingly keen to do a deal with anyone who could save members' jobs.

A rival consolidator, US Steel, has snapped up the assets of National Steel. The mini-mill Nucor steel company, which revolutionised the industry by making advanced slab-steel cheaply from electric-arc furnaces fed on scrap metal, has bought the mills of Trico Steel and Birmingham Steel. Mr Ross argues that more consolidation is needed, and that continued tariff protection for another year is the way to make sure it happens.

Gary Hufbauer and Ben Goodrich of the IIE argue the opposite. They note that most of the consolidation so brilliantly effected by Mr Ross and others has come from failing firms selling out to bigger companies under the threat of bankruptcy, mostly before the tariffs were introduced in March last year. Keeping the steel tariffs in place, they suggest, would simply mean sustaining higher prices for a while longer and enabling weak firms to stagger on for a few more years. Mr Ross himself concedes that one consequence of scrapping the tariffs would be more mill
closures, which rather proves his opponents' point.

But there could be relief on the way for America's mills—and, indeed, for President Bush—from an unlikely source. As the chart shows, world steel prices are rising. The reason is not so much American tariffs as China's insatiable appetite for raw materials and basic products such as steel. According to World Steel Dynamics (WSD), a research firm, last year China accounted for 31% of world steel consumption of 936m tonnes; 14% of which was imported. This was sharply up from 20% of the world total of 780m tonnes in 2001. The price of imported sheet-steel sold to China has risen from $240 a tonne to over $300, while Chinese domestic steel prices have risen by a fifth in the past year.

WSD is now forecasting a shortage of steel in the first quarter of next year, noting that by this summer the world's mills were running at 95% of capacity. As well as China's appetite for imported steel there are worries about shortages of raw materials, such as the coke and scrap iron needed in steelmaking. WSD thinks there is a strong chance of the biggest price spike since the mid-1970s. True, Asian relief would not last for ever. China is investing heavily in expanding its own steel capacity. Sooner or later much of that will flood on to world markets. But in the meantime, higher prices may give Mr Bush a win-win opportunity: to please domestic steel consumers and shock his foreign critics—who love to cite his steel policy as evidence of his arrogant unilateralism—by scrapping the tariffs, without doing much damage to what remains of America's steel industry. Go for it, Mr President.