The Economic Impact of the Trade Skirmish of 2018 on the Nation and Ohio

Limited Impact Today; Mounting Concern for the Near Future

By Edward (Ned) Hill and Fran Stewart
ACKNOWLEDGMENT
We thank Salman Ahmed of the Carnegie Endowment for International Peace for encouraging us to examine the impact of the trade skirmish on the economy of the United States with an emphasis on Ohio. Thoughtful comments and suggestions were also received from Trevor Brown, Brad Jensen, Steve Kelley, and William Shkurti. AJ Foltz and Sarah Hay analyzed the Federal Reserve’s Beige Books. Gennifer Valentini of The Ohio State University’s Ohio Manufacturing Institute designed the tables and figures, and the John Glenn College’s Director of Communications Hank Wilson designed and produced the report.

The findings, conclusions, and recommendations expressed in this report are the product of research conducted by the authors and do not represent the views of the John Glenn College of Public Affairs, The Ohio State University, the Ohio Manufacturing Institute, or the Carnegie Endowment for International Peace.
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EXECUTIVE SUMMARY

Ohio is front and center in the trade conflict sparked by the Trump administration’s initiation of tariffs in 2018 to protect the U.S. steel and aluminum industries. Ohio is also a state with much at risk if national security trade protection is extended to the motor vehicle assembly and parts industries. Under the regime of retaliatory tariffs in place at the end of 2018:

- Ohio had the largest exposure of any state to retaliatory tariffs imposed by Canada;
- China is the largest international destination for Ohio’s soybeans;
- Ohio is the nation’s second-largest production location of motor vehicles and parts, before GM shuts-down it’s Lordstown assembly plant;
- Ohio is the nation’s largest production location of motor vehicle engines;
- Ohio is the location of a major Chinese industrial investment;
- Ohio is a major supplier state to both Boeing and Airbus’s U.S. assembly operations;
- Ohio is a production center for appliances; and
- Ohio’s iron and steel mills produce the third highest value of output among the states.

We have two objectives for this public policy briefing. The first is to document and clarify the moves and counter-moves in 2018’s international trade fight. The second is to discuss the economic impacts of the trade skirmish on the nation in general and Ohio in particular.
Those seeking definitive answers, however, will be disappointed in this policy brief, and they should look with skepticism on those who claim to have them. We describe the impacts and consequences of the trade actions as clearly as possible, but the results to date are both mixed and muted. There is too much uncertainty about public policy and the future path of the economy to be certain about the outcomes. Businesses are just beginning to react to the tariffs as if they are more than a short-term event. Additionally, the United States-Mexico-Canada Agreement (USMCA) needs to be acted on by the legislatures of three nations, the Trump administration has not acted on the trade investigation that could declare the motor vehicle and parts industry to be vital to the nation’s defense, and, most importantly, not all of the trade cards have been dropped by both the United States and China. Only educated guesses can be made based on past experiences, current economic models, current data and survey results.

This policy brief proceeds in seven steps. The legal weapons the U.S. has deployed in the trade actions of 2018 are described in the first section. The second is a presentation of the trade actions: Who did what to whom and when. The third is a review of available economic estimates of the impact of the trade actions and possible additional measures. Evidence is presented on the impact of the 2002-2003 Bush steel tariffs, as are the results from four econometric models on the expected impact of the current ratcheting up of duties across the globe. The fourth portion of the brief examines the performance of the aluminum and steel, or metal-making, industries to determine whether the imposition of protective duties, or the anticipation of their imposition, had an economic impact. We present the metal-making industry data in sync with the way markets change—first looking for price movements that deviate from trend, then for changes in production levels, followed by increases in employment, culminating in potential investment in new or expanded plant and equipment. The fifth section is a review of the near-recession of 2015-2016 and its impact on the metals-making sector of the U.S. economy. Sixth, we look specifically at Ohio. The final section of the paper is our summing up.

We did not find any evidence indicating that Ohio’s employers or workers have experienced significant benefits from the American trade tariffs or the resulting trade skirmish, this includes metal-makers. And, at this point, they have not suffered major harm. The negative effects of the trade skirmish have been offset by the stimulus provided by the 2018 tax cuts and extremely strong consumer spending. The downsides from the trade war will be experienced as the stimulative effects of the tax cuts diminish, domestic manufacturers adjust their supply chains in reaction to increased costs, the global economy slows—partly in reaction to global trade tension—and business investment is trimmed due to increasing uncertainty about global economic performance.

The $3.3 billion in exports from Ohio to Canada, China, Mexico, and the European Union that is estimated to be affected by retaliatory tariffs needs to be put into context. Ohio exported $37.1 billion in goods (physical products) to these nations in 2017, meaning that 8.9 percent of the state’s exports of goods could be subject to their retaliatory duties. Ohio exported roughly $50 billion in goods in 2017 to all nations, but data on retaliatory duties from those outside of the four major trading partners are not available.

In terms of employment, Ohio’s Development Services Administration estimated that 260,000 full time equivalent jobs depend directly or indirectly on trade. These are jobs in exporting companies and in their supply chain. In May, 2018 Global Affairs Canada reported that 291 Canadian-owned companies directly employed over 25,000 Ohioans and that nearly 309,000 jobs in Ohio are dependent to some extent on trade with Canada or Canadian investment. This includes jobs in exporting companies and in their supply chains and jobs supported by the spending of those employees. The U.S. Chamber of Commerce estimated that 1.5 million of the state’s 5.0 million private-sector jobs are supported directly, indirectly or by spending by those employees.
The largest unanswered public policy question that Ohioans, especially Ohio’s business leaders, ask regarding trade is, What is the best way to address trade problems with China?

Ohioans understand, and oppose, trade barriers caused by China’s formal and informal policies on market entry, intellectual property theft and forced technology transfer, and interference with foreign corporate ownership of facilities in China.

Ohioans understand the troubles that can be caused if state-supported dumping of Chinese steel and aluminum occurs as the global economy slows. However, this is a global problem, not just a problem for the United States.

Ohioans do not understand is why the U.S. has gone to the mat wrestling with its closest trade partners and historic allies—Canada, Mexico and the European Union—when the nation’s dominant current and potential trade problems are with China.

Ohioans do not understand is why the United States attacked a multilateral coalition of trading partners that could be strong allies in countering China’s mercantilist trade practices.

Ohio’s manufacturers do not understand is why they are being taxed, or “tariffed,” in a global trade war designed to protect the U.S. steel and aluminum industries and how this is related to opening Chinese markets to U.S. investment.

Ohio’s manufacturers also do not understand assertions that charging them tariffs is good public policy and how increasing their costs improves their competitive position.

The net impact of the current trade conflict on Ohio’s industries cannot be assessed in isolation from its impacts on the U.S. and global economy— as those impacts will, in turn, affect Ohio’s economy. We stress that, while the current trade actions are not harmful enough to trigger a recession on their own, they are kindling that can feed the fires of recession by increasing costs of consumer goods, harming the construction industry, and increasing domestic motor vehicle production costs at a time when the industry has passed a cyclical peak and may have passed its secular peak and when the stimulus provided by the 2018 tax cuts is diminishing.

In sum, it is too soon to be declaring the winners and losers in Ohio from the Trump administration’s trade measures. However, there are enough data available to gauge effects of the measures as they reverberate throughout the state’s industries.
Findings

Bush-Era Steel Protection Failed

The picture the International Trade Commission drew of the George W. Bush-era tariffs was grim: “The [econometric] model [used by the ITC] estimates that earnings in industries where returns to capital fell, including steel-consuming industries, would decline by $601.2 million.” “Industries that are particularly affected include motor vehicle parts and several steel fabrication industries (metal tank manufacturing, railroad rolling stock manufacturing, and power boiler and heat exchange manufacturing).” Gary Clyde Hufbauer and Ben Goodrich of the Peterson Institute for International Economics also examined the impacts of the 2002-2003 tariffs, concluding that “President Bush's decision to protect the US steel industry with Section 201 tariffs had no economic justification... tariffs would cost over $400,000 annually per job saved in the steel industry. Moreover, they would result in net job losses in the economy due to downstream layoffs.” In other words, the tariffs hurt the customers of domestic steel as well as consumers.

Econometric Models Forecast Recession from Escalating Tensions

We draw out several observations about the potential effects of the trade frictions from econometric models of the U.S. economy. The first is that the stimulus that came from deficits associated with the December 2017 Trump tax cuts have, as expected, boosted the economy in 2018 and will continue to do so through early 2019. The stimulus from deficits associated with the tax cuts appears to have offset economic losses from retaliatory trade sanctions and increased prices on domestic products from U.S. imposed duties. If, however, the trade conflict escalates from a skirmish to sustained trade tension with China, with the steel and aluminum actions and counteractions still in place, then the U.S. is projected to experience, at best, diminished growth in 2019 and possibly a recession beginning in mid-2019, extending through 2020. If the trade war intensifies, with U.S. tariffs on imports coming from China increasing to 25 percent on, or after, March 1 and an additional 25 percent tariff hitting automobiles, trucks and parts coming from outside North America, a recession is likely to start in 2019 as the trade skirmish escalates into a global trade war and last through 2020. GDP growth is projected to decline by nearly 2 percentage points from baseline forecasts in the first quarter of 2020; full-time equivalent job losses above the baseline forecast would cross the million mark before mid-year 2019 and go above 2 million between the last quarter of 2019 and the first quarter of 2020, staying above 1.5 million throughout 2020.
If the tariffs perform as we expect, higher prices for U.S. steel and aluminum are likely to be coupled with limited growth in production, as domestic mills gain market share and sales increase even in the face of declining overall demand. Employment gains in these two sheltered industries will be slow and modest because mills will likely use overtime to satisfy near-term increases in demand. New or expanded production capacity will take longer to bring online, and companies will hedge their bets on expansion as they wait to see if a recession is on the horizon and whether the new tariff wall will stay up to protect their investments. To date, industry data are bearing out our expectations.

STEEL PRICES

The United States was a high price island in world steel markets before fall 2017, and the price gap has widened since the steel tariffs were imposed. While market forces have reduced the cost of steel in the U.S. from the highs of mid-summer 2018, when the cost of a metric tonne of hot rolled band steel produced in the U.S. exceeded $1,000, prices have also been going down in China, reflecting that country’s economic slowdown. As of January 28, 2019, the cost of a metric tonne of hot rolled band steel in the U.S. was 64 percent higher than its cost in China ($764 compared to $467) and 39 percent higher than its price in Western Europe ($764 versus $548). While the price of hot rolled band steel has been declining in all three markets, the differences in the factory-gate prices among U.S., Chinese and European product remain large.

These cost differences can either steer the location of a metal-using product’s manufacturing operations out of the United States or shift where a metal-using product is sourced. The longer the trade skirmish carries on, the higher the probability of either offshoring production or sourcing metal-using products in regions with lower metals prices and the higher the probability of regional, if not national, recessions in the United States.

PRICE IMPACTS ON METAL-USING COMPANIES

Conversations with Ohio manufacturers and their representatives as well as with members of the construction bar indicated that, during the summer and fall, metal-users were mostly able to pass the tariff costs and increased metals prices along to their customers. In cases when they could not metal-users absorbed increased costs either out of profits or retained earnings. All of this was done expecting that the tariffs would be short-lived. The longer the tariffs go on, the more business will be lost to competitors with lower costs, both in domestic and international markets.

GROWTH IN DOMESTIC PRODUCTION

Steel production from U.S. factories started to increase in January 2017, which is after the economic slowdown, or the near-recession, of 2015-2016 ended and before the tariffs were announced. The production index (where 100 indicates that the volume
produced is equal to average monthly production in 2012) for raw steel fluctuated around 93.4 for most of 2017. In February 2018, the index moved up to 100.0. In June, when the duties were put in place, the index was 100.3; dropping to 100.2 in December. The fairest assessment of the change in the index of production of raw steel is to note that the index went from an average of 93.4 over 2017 to an average of 99.6 in the first half of 2018; then on to an average of 102.2 from June through December. The percent increase in raw steel production from the 2017 average to the average for the first half of 2018 was 6.6% and the percent increase from the average index of the first half of 2018 to average index value over the post-tariff second half of 2018 was 2.6 percent.

Was the increase from 2017 through the end of 2018 due to tariff-induced increases in market share, or a continuation of increased output due to the strength of the domestic economy? A dramatic discontinuity in the volume of production is not associated with the imposition of protective tariffs in June.

STAGNANT METALS-PRODUCING EMPLOYMENT GROWTH

U.S. employment in the steel-making industry has been stagnant. In January 2018, when duties were first mentioned by President Trump, the U.S. steel industry had 83,500 jobs. In March, when U.S. tariffs were announced, the iron and steel industry had 82,400 jobs. June's jobs number increased to 83,500. In December the number of jobs was 83,200, slightly less than at the beginning of the year.

The story is much the same for the aluminum-producing industry. The number of jobs in the industry was the same in December 2018 as it was in July.
All of the steel plant expansions that have taken place in Ohio, with the exception of Republic’s Lorain mill, were in the works months before the Trump administration undertook its trade actions. New mills, such as Petmin’s proposed new half-billion-dollar pig iron mill in Ashtabula and revitalized facilities, such as JSW’s investments in the former Wheeling-Pitt mill in Mingo Junction, were planned and proceeding through regulatory processes well before the steel duties were announced. Nationally, projects that were announced after the tariffs were enacted were being studied in light of current market conditions (demand) and the permanence of the duties. Would these investments have been made based on the trend in market conditions without the imposition of duties? We do not know for certain, but we suspect that, with the exceptions of the reopening of U.S. Steel’s mills in Lone Star, Texas, and Granite City, Illinois, and Republic’s expansions in Ohio, the answer is yes. However, even in the case of U.S. Steel, the motivation for reinvestment and restarting the furnaces goes beyond the erection of a new tariff wall. The Granite City and Lone Star facilities produce pipe, and the oil production boom in Texas’s Permian Basin has provided a market that was absent in 2015 and 2016 when the plants were idled.

We also look at the $1.3 billion investment made by Big River Steel in Osceola, Arkansas. This massive project was proposed in 2013, production started in early 2017, and, in 2018, the company started planning a matching $1.2 billion expansion in Osceola and in April signed an option to build a new $1.6 billion plant in Brownsville, Texas. Big River Steel is a market-driven warning that the legacy steel industry in the United States may have to relearn a lesson that was taught in the past. Tariff walls and trade protections offer temporary respite from dumping or competition. However, the real economic challenge is investment in new metal-making technologies with lower operating costs and higher quality product located closer to growing markets. The possibility of dumping by Chinese state-supported mills when the economy slows is clearly unacceptable. That is a near-term threat. The long-term threat to legacy steel is located in Osceola. The rise of the modern flex-mill is as large a threat to integrated steel mills and older mini-mills today as Nucor was in the late 1980s.

Growing Perceptions that the Trade War Is Hurting the Economy

FEDERAL RESERVE BOARD OF GOVERNORS’ BEIGE BOOKS

Anecdotal observations in the press of negative impacts from the trade skirmish have increased over time as supply chains have begun to experience tariff-driven cost increases and lost business. These comments have been replicated with another set of data points in the Federal Reserve System’s Beige Books. The January 2019 book reported that “many Districts reported that contacts had become less optimistic in response to
increased financial market volatility, rising short-term interest rates, falling energy prices, and elevated trade and political uncertainty. … Most Districts indicated that firms’ input costs had risen, but reports were mixed on whether they could pass the higher costs on to customers. Reports often cited rising materials and freight prices as sources of cost increases, and a number of Districts said that higher tariffs were also a factor.” In the December 2018 book, 11 of the 12 Districts mentioned trade and tariffs negatively. This is a major change from reports made in the summer and early fall.

2019 OHIO MANUFACTURERS SURVEY

The affiliates of the Ohio Manufacturing Extension Program undertook a survey of manufacturers from mid-November through early-January on perceived strengths, weaknesses, opportunities, and threats to their businesses. Two of the questions directly related to trade concerns. The first asked whether “the recent tariffs imposed by the U.S. affected your company.” The second asked an open-ended question about which government regulations “concerned them the most.”

The question on the impact of trade actions was answered by 493 companies. The vast majority reported some degree of harm. The ratio of the extreme answers, those “very negatively” and “very positively” affected, was nearly 14:1. The ratio of manufacturers very negatively or negatively affected to those very positively or positively affected was nearly 9:1.

The 2018 and 2019 polling asked respondents the same open-ended question: “What government regulations concern you the most?” Close to the same number of companies answered the question in each year, 236 in 2018 and 213 in 2019. In 2018, only 4% of the respondents (9) identified tariffs as an area of regulation that concerned their companies. One year later, 141 establishments out of the 213 that answered indicated that tariffs were an area of concern; this constitutes 66 percent of those answering the question.
Observations and Conclusions

Ohio’s workers, businesses, and consumers face three different negative impacts from the current set of trade actions: (1) higher prices for purchased parts made with metal and imported materials resulting in lost domestic markets as customers source metal-using parts and finished products internationally, (2) lost international markets for both manufactured and agricultural products due to increased prices caused by retaliatory tariffs, and, ultimately, (3) higher prices for domestic consumer goods.

A reasonable question to ask is what is behind the strong performance of the national and Ohio economies if there is a trade war going on? The first response is that the drag from the current trade skirmish is just not large enough to cause an immediate downturn in the economy. However, economic decline will likely occur if the sanctions on China are ratcheted up and the U.S. imposes a new global duty against automobile imports and parts. The second response is that the duties are relatively new and trade statistics show an accelerated flow of shipments into the U.S. from China in advance of the threatened increase in duties that were to take place on January 1, 2019, and are now postponed to at least March 1. Supply chains have not been disrupted—yet. Our third response is that deficits associated with the tax cuts that took effect in 2018 generated enough consumer spending to offset the economic drag associated with the tariffs imposed from June through September. This source of stimulus will diminish in 2019.

Our conclusion about the impact of the tariffs on Ohio, Ohio’s steel industry, and Ohio’s metal-using industries is consistent with the observation of a senior economic analyst in Ohio’s state government: “The story of how the Trump administration’s tariffs impact facilities in Ohio is yet to be written. Lots of noise, news stories about what is to happen, but I have yet to see job and investment impact as of September 2018. Maybe next year there will be real data to point to, but after six months, most companies are taking a ‘wait and see’ approach before committing dollars, investment, or production. Overall, there is way too much on-again, off-again news to make a definitive decision.”

The comment holds true five months after it was recorded. However, anecdotal data coming from corporate earnings reports, comments recorded in the Federal Reserve’s Beige Book, and answers to the Ohio Manufacturers Survey all point to accumulating damage. The current trade skirmish is not disruptive enough to trigger a recession on its own. However, growing trade tensions between the U.S. and China, threats of additional trade actions against Europe, and continued actions against Canada and Mexico, coupled with signs of a softening domestic economy may provide enough kindling to stoke the fires of recession — either regional or national.