

US Trade Policy: Promoting \$300 Crude¹

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The United States took unilateral action on trade this week, angering many of the nation's former allies. Tariffs of twenty-five percent were assessed on steel imports and ten percent on aluminum imports from the European Union, Canada, and Mexico.

The tariffs were justified using Section 232(b) of the Trade Expansion Act of 1960 as amended. The leaders of the targeted countries all expressed anger, asserting they were (or had been) allies and thus their exports to the US did not threaten national security. French president Emmanuel Macron, for example, reacted strongly: "This decision is not only unlawful but it is a mistake in many respects. Economic nationalism leads to war."² These leaders are correct but fail to recognize the law's intent. Section 232(b) is designed to preserve US industrial capacity in case of war. Some can argue that US security would suffer if Europe were attacked. It is harder, though, to defend the application of the authority against Canada.

Prime Minister Trudeau of Canada echoed Macron's sentiments:

"Let me be clear: These tariffs are totally unacceptable," Trudeau said. "Canadians have served alongside Americans in two world wars and in Korea. From the beaches of Normandy to the mountains of Afghanistan, we have fought and died together."³

He added that

"These tariffs are an affront to the long-standing security partnership between Canada and the United States, and in particular, to the thousands of Canadians who have fought and died alongside American comrades-in-arms."

The United States' trade actions have created enormous acrimony among our allies. At the same time, they threaten jobs here because the higher-priced steel is causing manufacturers to seek supplies of intermediate goods from China and other countries. The evidence of a boost to the US economy has yet to emerge.

What has emerged, though, is a vitriolic reaction to the United States' tariffs. This *Financial Times* headline says everything: "US fires first shots in trade war with allies."

European countries, though, are not united in protest. Politicians in Germany, which exports large quantities of goods to the US, want to proceed carefully while Macron calls for a strong European response. Europe will dither. Thus, the United States' effort to impose import fees on steel, aluminum, and probably automobiles will most likely succeed.

In twelve to eighteen months, Europeans who want to retaliate will have their opportunity, and one should expect them to take it. The chance will come if US gasoline prices begin to skyrocket as the IMO 2020 rule takes effect, as we project they will. As oil prices rise, US politicians, especially the Trump administration,

¹ Excerpted from "Neglecting Hoarding; Blackmailing Allies," *Notes at the Margin*, June 4, 2018.

² Paul Withers, "'It's ILLEGAL and could lead to war,' Macron in furious outburst at Trump's EU tariffs," *Sunday Express*, May 31, 2018 [<https://tinyurl.com/y7bh52ts>].

³ John Bowden, "Trudeau: Trump tariffs 'are an affront' to Canadian soldiers who 'fought and died' alongside Americans," *The Hill*, May 31, 2018 [<https://tinyurl.com/yd97y5ze>].

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will seek to moderate the increase. No doubt, they will see the IMO 2020 fuel rule as the culprit. Logically, they will attempt to have the rule relaxed, at least for a few years.

As we understand it, the Europeans have been the strongest proponents of imposing the IMO marine-fuel standard in 2020 rather than phasing it in through 2025. Furthermore, it appears the rule cannot be changed without European cooperation. The US actions on trade decrease the likelihood of the Trump administration getting this cooperation. Indeed, it seems likely that US consumers (and the US economy) will suffer the full impact of the rule change.

Researchers Uzi Segal and Joel Sobel predict these consequences in their *Journal of Economic Theory* article titled “Tit for Tat: Foundations of Preference for Reciprocity in Strategic Settings.” The paper focuses on game theory and is very mathematical. One sentence in the summary, though, says everything one needs to know: “The framework is rich enough to describe the behavior of individuals who repay kindness with kindness and meanness with meanness.” Their study also shows that this type of feeling can overwhelm rationality.⁴

Europe may demand that the United States ratify the Paris Accords on climate change as a treaty should we request a relaxation of the IMO 2020 regulations. Such a demand would leave the current administration with a Hobson’s choice: accept high gasoline prices and an economic slowdown in 2020 or adopt and adhere to the “draconian” climate accords.

President Trump will likely turn down this deal, should it be offered. Thus, we conclude that his actions on trade decrease the chance of the IMO 2020 implementation being moderated or extended. This increases the chances for higher crude prices and refining margins as well as a recession in 2020.

⁴ Uzi Segal and Joel Sobel, “Tit for tat: Foundations of preferences for reciprocity in strategic settings,” *Journal of Economic Theory* 136, No. 1 (September 2007), pp. 197–216 [<https://tinyurl.com/yclh3zj9>].