



Trump's Really Bad Idea

by Richard W. Rahn

WITH HIS TARIFF PROPOSALS, TRUMP MISSES THE TRADE BASICS

Why does Virginia import oranges from Florida rather than grow its own? Why does the U.S. import almost all of its coffee and cocoa beans from countries in tropical climates rather than grow its own? Why does the U.S. import most of its primary aluminum rather than produce its own?

The obvious answer is that it's much cheaper to import these commodities rather than try to produce them all at home — and, as every first-year economics student should know, trade increases living standards among both buyers and sellers — because bigger markets normally lead to lower costs, and different locales have comparative and absolute advantages in producing certain goods and services.

With his steel and aluminum tariff proposals, President Trump seems to have missed some of the trade basics that Adam Smith and David Ricardo taught the world more than two centuries ago.

Imported aluminum accounted for 64 percent of all aluminum used in the U.S. last year. By far, the biggest foreign supplier to the U.S. last year was Canada.

Aluminum is the most widespread and useful of all metals. It is lightweight, corrosion resistant, highly conductive and reflective, easily formed, durable, and recyclable. It is widely used in transportation, packaging, construction, and electrical and machinery products. Aluminum is produced primarily from bauxite ore, which is then chemically extracted by a refinery into alumina.

The alumina is then smelted to produce pure aluminum metal. The smelting process is highly energy intensive, typically accounting for about 40 percent of the cost of primary aluminum. As a result, aluminum smelters are typically built near low-cost sources of electrical energy.

More than half of all aluminum now consumed each year is produced from secondary aluminum — that is, aluminum scrap. The reason being it is very easy to recycle aluminum, which can be done at approximately 10 percent of the energy cost of producing primary aluminum. About two-thirds of U.S. aluminum production is from secondary production.

Even though there are only a couple of firms left in the U.S. that produce primary aluminum, there are many that produce secondary aluminum and thousands that produce aluminum products from primary and secondary aluminum. A tariff on primary aluminum imports may be beneficial for those couple of producers, but it is insufficient to cause more companies to invest in smelters, and it raises costs for all of the aluminum product producers and consumers.

In 2016, the top six aluminum producing countries accounted for 77 percent of the world's smelter capacity (primary aluminum), with the Chinese accounting for 54 percent, while the United States ranked number 6. The U.S. has higher energy costs than Canada (because Canada has abundant, low-cost hydropower), so much of the North American primary-aluminum production has migrated to Canada.

The aluminum industry in the two countries is highly integrated, with considerable cross-ownership and marketing relationships. When properly viewed as one (Canada and the U.S.) production and marketing area, North America is self-sufficient in primary, secondary and aluminum-product production.

The world is plagued with excess primary-aluminum production capacity because of the great incentive for each company and country to build the most efficient smelter in the world — using the lowest-cost energy and latest technology — as a way of driving down their relative costs.

China foolishly continues to build new smelter capacity even though it has no inherent energy cost advantage and, in fact, is reputed to have higher production costs than the U.S. If

China was a true market economy, it would be importing aluminum from lower-cost producers.

China, by selling some of its aluminum below full costs (under accepted accounting conventions), is in effect giving away some of its product — which is a gift to aluminum product producers and final consumers. The Chinese worker is subsidizing Americans who drink beverages from aluminum cans.

American and other producers of primary aluminum are obviously unhappy that the Chinese are selling below full cost — which hurts their workers and stockholders. But this is a small group compared to all of those employed in the aluminum-product industries and the final consumers of aluminum products. China's below-cost sales may enable Ford to sell its aluminum pick-up truck at a saving of \$200 per truck to the final consumer.

All of those American buyers of the trucks now have more money in their pockets to buy other goods and services — like meals in restaurants, where more American workers are employed.

The U.S. Department of Commerce produced a report in January, "The Effect of Imports of Aluminum on the National Security," which provided much of the rationale for the proposed aluminum tariff. The report focuses on domestic U.S. smelter capacity rather than North American capacity (which is the relevant area given our defense-sharing agreements with Canada that go back more than 70 years, and the integration of the aluminum industry in the two countries).

The report also largely ignores the enormous U.S. secondary-aluminum capacity. The Chinese account for about 3 percent of U.S. aluminum consumption — which is no national security threat given the ability of the U.S. and all of our friends to satisfy its absence in a matter of weeks.

The proposed aluminum tariff makes no economic or political sense — a really bad idea.

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