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Preventing a Trade War: Germany's Dilemma on U.S. Tariffs on Steel and Aluminium

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Germany is among the countries that have much to lose in case of an escalation of the current trade dispute with the U.S. Therefore, despite President Donald Trump's administration imposing tariffs on steel and aluminium from the EU, Germany favours continuing talks and seeking compromise. From the Polish point of view, Germany's caution is beneficial: it reduces the risk of a political crisis in transatlantic relations, protects economic interests, and creates an opportunity to block the construction of the Russia-backed Nord Stream 2 gas pipeline.

In March, the U.S. announced it would impose higher duties on imports of steel and aluminium. The rates of 25% and 10%, respectively, were not initially applied to imports from the European Union due to ongoing talks between the parties about the possibility of a compromise. They ended with no result, so from 1 June, the protectionist regulations also include EU companies. The U.S. and Europe are entering into open economic conflict and escalation cannot be ruled out. Germany is undoubtedly among the EU Member States most concerned with this possibility.

Costs of the Conflict. The least problem seems to be the direct effect of the U.S. tariffs on the steel sector itself. Producers, among which the largest are Salzgitter from Lower Saxony, Dillinger Hütte in Saarland, and Thyssenkrupp, expect a drop in the order book, but certainly not on a scale threatening the 85,000 jobs in the industry. The Germans also take solace in the fact that U.S. companies are highly dependent on the import of specialised steel products from Germany; therefore, after the introduction of duties, they will probably apply for an exemption from the new regulations.

However, the concerns increase if the indirect effects on competition on the global market are considered. Trump's decision does not concern only the EU but also producers from Asia and Russia who are already trying to cushion the effects of duties by increasing sales in other markets. As a consequence, there may be a long-lasting drop in prices, which will complicate the situation of the European, including the German, producers.

Escalation of the trade conflict is even more worrying. If the EU retaliates, the probability of the U.S. introducing customs duties on other products, like cars, increases significantly. That would be a painful blow to the German economy since its automotive industry exports 500,000 cars to the U.S. and around 200,000 jobs are dependent on that market. In addition, German producers would have to adapt their delivery and supply networks, which would certainly entail huge costs.

The escalation scenario is connected to a fear about the stability of the entire international trade system, to which Germany owes its good economic condition to a considerable degree. The country's exports outside the EU amounted to €529.3 billion in 2017 (slightly more than 40% of total exports) and was responsible for the dominant part of its €244 billion trade surplus. The U.S. actions may encourage other countries to become more protectionist, too, which would put into question the current, export-dependent, economic growth model in Germany. Additionally, turbulence in trade may translate into political problems. It cannot

be ruled out that the conflict on tariffs—especially if long-term—can weaken transatlantic ties and hinder cooperation within NATO.

Germany's Dilemma. The European Commission, which is responsible for EU trade policy, has been striving in recent months to maintain the unity of the Member States in the face of the approaching tariffs. In the early spring it was possible to agree that if the U.S. imposed tariffs, the EU should launch procedures in the World Trade Organisation (WTO) and prepare to introduce measures that target imports of products significant to the U.S. economy worth a total of €2.8 billion (including soybeans, whiskey, textiles, and even Harley-Davidson motorcycles). At the same time, the EU was to offer talks on facilitating access to the European market, provided it was unconditionally and permanently exempted from protective duties on steel and aluminium.

The government in Berlin had assumed that the EU's position would mainly be a demonstration of strength and the talks would lead to an agreement. The calculation turned out to be wrong and Germany has found itself in a very uncomfortable situation. The EU's tough response instead may have speeded up the introduction of U.S. customs duties on cars and started a trade war that may have lasting political consequences for transatlantic relations. On the other hand, the lack of or weaker-than-expected reaction could be viewed by Trump as an incentive to push for more protectionist tools. The attempt to escape this dilemma for Germany is to support, on the one hand, the introduction of retaliation measures against the U.S. and, on the other hand, signal to the Americans its readiness to talk and make concessions. The U.S. could be offered joint reform of the WTO, a new trade agreement containing, for example, a reduction of duties on industrial or agricultural goods or support for the sale of U.S. liquefied natural gas (LNG) on the European market. Another concession to the U.S. could be a faster-than-expected increase in defence spending. Admittedly, German Chancellor Angela Merkel has ruled out such a move, but it is obvious that it would reduce the imbalance in trade with the U.S. (e.g., through the purchase of American weapons) and silence the Americans' allegations of ignoring Allied commitments in NATO.

German brainstorming about possible actions towards the U.S. has been criticised in the EU. There are accusations, for example, from MEPs, that the Merkel government is pushing primarily its own economic interest and undermining the exclusive competence of the EU in trade policy. Quite irritated is France, which is leaning toward tightening the course on the U.S. Punitive tariffs are meant to be a response not only to American protectionism but also to its withdrawal from the nuclear agreement with Iran and the undermining of international climate agreements. French politicians are convinced that EU action should hit Republicans campaigning for Congress. The duties, therefore, should be maximally politicised by imposing them on products manufactured in U.S. states most important to that party's electoral calculations. This would be a signal to Trump that while the U.S. thinks it can divide Europe, the EU has the potential to influence the internal situation in America. The French are hoping for a repeat of the 2003 scenario when President George Bush withdrew a duty on steel after a strong EU response.

Poland's Perspective. Poland's point of view on the trade conflict between the EU and the U.S. is definitely closer to Germany's than to France's. The key is the political factor: Escalation of the dispute risks weakening NATO and the loss of the American security umbrella. Economic interests also speak to the continuation of talks and possible concessions. Although Polish exports are slightly dependent on the U.S. market in a direct way, the threat is the strong link to the German car industry. If in response to EU retaliation the Americans impose duties on Volkswagen and Daimler vehicles, these companies' factories in Poland and sub-suppliers also will be affected.

However, having similar perceptions of the issue as the Germans does not guarantee concurrence on proposals to prevent escalation of the conflict with the U.S. It would be unfavourable for Poland to offer the Americans asymmetrical concessions in trade in industrial and agricultural products. In both sectors, Poland has gained a strong position in the European market in recent years. Opening it up to imports from the U.S. could mean putting this advantage at risk. But other actions may count on Poland's support. For example, increasing German military spending would increase NATO's military capabilities and extinguish disagreement between its members over meeting the obligation to spend at least 2% of GDP on defence. In addition, Poland probably would be an economic beneficiary of increased demand in Germany and could count on a further increase in exports. The most promising area of concessions, however, is in energy policy. The U.S. government does not hide that it considers the construction of the second branch of the Nord Stream pipeline a threat to American interests and is ready to even impose sanctions on companies involved in its construction. From Poland's point of view, it is worth persuading its partners in Berlin that by ending support for Nord Stream 2 and reducing further the dependence on Russia in energy policy, they could not only obtain U.S. concessions in trade policy but also dispel many doubts about Germany's political intentions towards Central Europe.