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The latest protectionist trade trends and their impact on the European Union

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Abstract

In an attempt to rebalance trade with China, the United States administration decided in early 2018 to introduce a series of protectionist measures affecting certain imports in particular. This gave rise to an escalation of US-China trade tensions. The new tariffs have affected a significant percentage of Chinese exports to the United States, but their impact on EU trade has only been marginal to date. The indirect effects on European economies through the global value chains have also been limited. However, possible tariff barriers on the automotive sector could raise the affected trade flows substantially.

Simulations made with econometric models confirm that the tariff measures adopted to date would have relatively moderate direct effects on global economic activity and on EU countries. That said, the simulations also warn that a decrease in business confidence and an unfavourable reaction by international financial markets could amplify such adverse effects. Additionally, possible future auto sector tariffs could have a significant impact on European economies in an industry already facing important challenges associated with the structural and technological transformation process currently under way.

Keywords: protectionism, global trade, tariffs, European Union, China, automotive industry.

JEL codes: F01, F40, E50, E60.

THE LATEST PROTECTIONIST TRADE TRENDS AND THEIR IMPACT ON THE EUROPEAN UNION

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Introduction

In early 2018, the US Government started to make good on the threats to raise trade tariffs that had figured prominently in President Trump's election programme. The adoption of protectionist measures, first mainly aimed at China, has sparked fears of a trade war and has since then weighed on world trade growth and corporate investment decisions. As D. Rodrik (2018) argues, the disruptive potential of the Trump administration's initiative stems more from its unilateralism, clearly far from the rules embodied by the World Trade Organization (WTO), than from its quantitative significance. So far, the actions taken are considerably less important than, for instance, the trade measures negotiated in the 1980s by the Reagan administration.

The tariff hikes adopted to date hardly affect EU trade directly, but the deterioration of confidence and the higher uncertainty about the world economy could have very adverse indirect effects on such open economies as the European ones. Only a small portion of the measures ordered by the US administration to date have been directly aimed at the European Union. However, these tensions have adverse effects on European countries through the global value chains, as they reduce exports of inputs to the United States and other directly affected countries. Also, higher uncertainty, the loss of investor confidence and adverse financial market reactions would affect the EU economy through the different transmission channels. Lastly, the possible imposition of tariffs on cars would have very harmful effects on what is a key industry for several EU countries.

This article reviews the trade protectionist measures adopted by the US administration in 2018. It then describes in greater detail the trade relations between the United States and the euro area. Lastly, it describes some simulations of the impact of such measures, focusing in particular on the euro area.

The Trump administration's trade policy

In 2018 the Trump administration began to define the trade policy agenda announced during the presidential campaign. Despite the emphasis on possible protectionist measures that characterised the campaign, no significant initiatives in this respect were adopted during President Trump's first year in office (2017), aside from the US withdrawal from the Trans-Pacific Partnership (TPP), a free trade treaty between 12 Pacific countries, and the interruption of trade negotiations with the EU on the Transatlantic Trade and Investment Partnership (TTIP), a free trade agreement discussed under the Obama administration. However, in early 2018 the US administration began to introduce a series of concrete measures (see details in Table 1).

The measures adopted gave rise to immediate retaliation by the affected economies. The tariffs imposed in January on imports of solar panels and washing machines and the 25% and 10% tariffs on steel and aluminium adopted in March were levied across the board. The EU, Mexico and Canada were granted a temporary exemption from the metal tariffs, but it expired in June, prompting them to adopt counter-measures for an equivalent value on exports from the United States. Such measures had been previously adopted by China, India and Turkey.

The escalation of tensions with China increased the risk of a trade war. In the following months, an investigation conducted by the US Trade Representative led to the detection of illegal appropriation of US technology by Chinese firms. As a result, the US administration

January 2018	30% and 50% tariffs on imported solar panels and washing machines
March	25% and 10% tariffs on imported steel and aluminium; temporary exemption for the EU, Mexico and Canada Chinese retaliation on \$3 billion worth of US imports (in response to metal tariffs)
May	Start of US investigation into vehicle imports
June	End of temporary exemption granted to the EU, Mexico and Canada regarding metal tariffs
June/July	EU, Mexico and Canada adopt retaliatory measures
July	Bilateral trade agreement between the United States and the EU
July/August	25% tariffs on \$50 billion worth of imported technological goods from China Chinese retaliation on an equivalent value of US imports
September	10% tariffs on \$200 billion worth of imports from China Chinese retaliation on \$60 billion worth of US imports
December	Truce in the US-China trade war
February 2019	US investigation into vehicle imports concludes

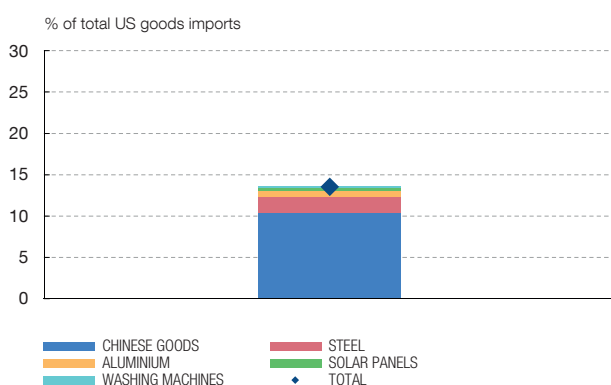
SOURCE: Author.

UNITED STATES IMPORTS AFFECTED BY PROTECTIONIST MEASURES

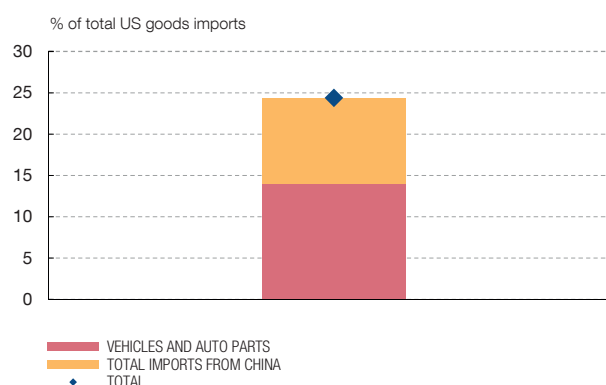
CHART 1

The protectionist measures imposed by the Trump administration currently cover a limited percentage of US goods imports, although possible additional tariffs could significantly raise the share affected.

1 EXISTING



2 ADDITIONAL



SOURCES: PIIE, US Census and own calculations.

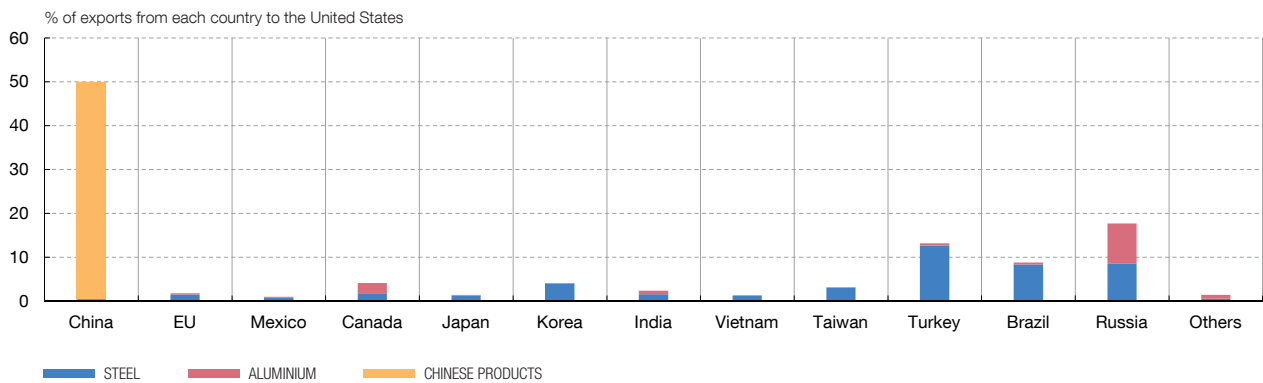


decided to impose tariffs of 25% on imports of technological goods from China. This measure was followed by Chinese retaliatory measures on US products for an equivalent value. Finally, in September the United States introduced additional 10% tariffs on import flows from China worth \$200 billion, which also triggered retaliation.

The new tariffs affect a significant percentage of exports to the United States. The protectionist measures promoted by the Trump administration affect a limited, albeit material, percentage (13.6%) of its imports (see Chart 1). The most significant measures are those involving goods specifically from China (10.4%), followed by trade barriers on metals (2.7%), while tariffs on solar panels and washing machines only account for 0.5% of import flows.¹ From China's perspective, half of its exports to the United States are currently

¹ According to Bown and Zhang (2019), the percentage of US imports affected by protectionist measures imposed by the Trump presidency would decline to 11.2% if only import flows not subject to restrictive measures prior to 2018 are considered. The percentages relating to metals also include tariff-exempt countries whose exports to the United States are subject to quantitative restrictions.

The United States' protectionist measures mainly affect Chinese exports.

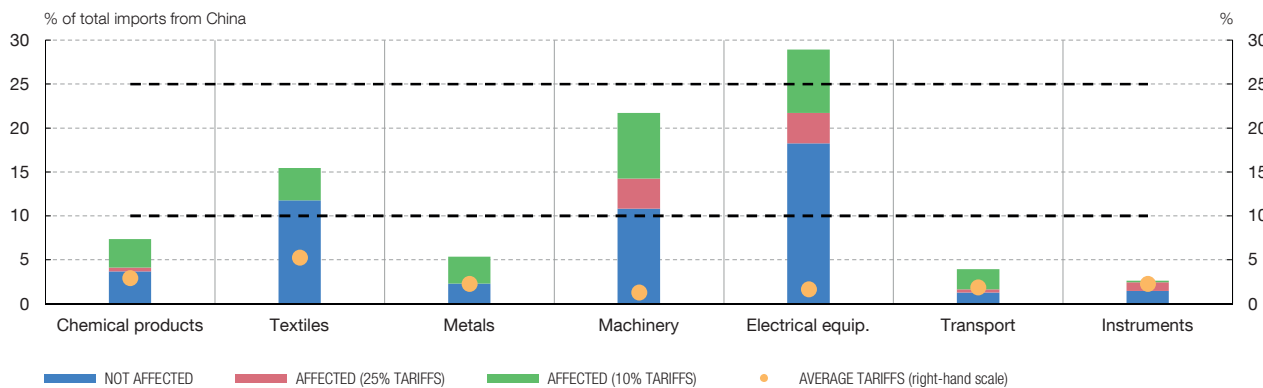


SOURCES: PIIE, US Census and own calculations.



UNITED STATES IMPORTS FROM CHINA: MAIN SECTORS (a)

US tariffs affect key sectors of bilateral trade with China, substantially raising tariff barriers compared with the previous ones.



SOURCES: PIIE, USITC, US Census, WTO and own calculations.

a 2017 figures.

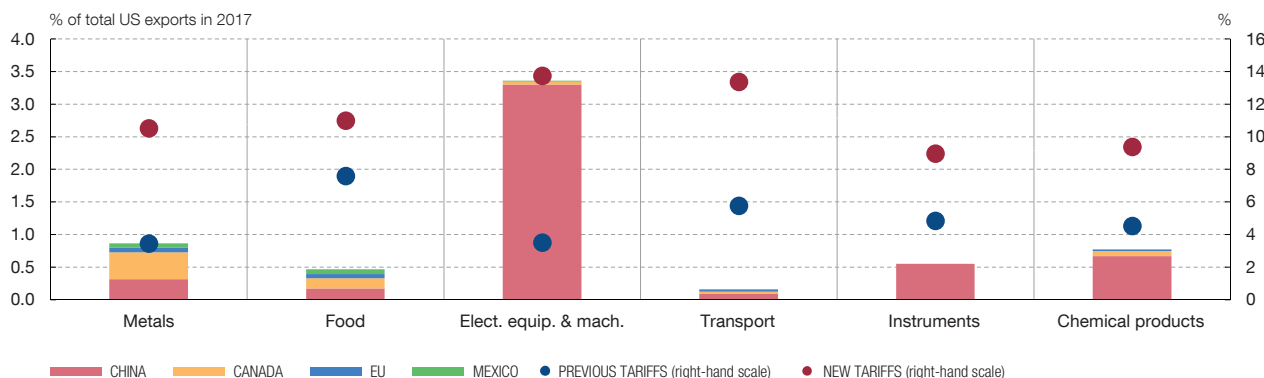


affected by special tariffs (see Chart 2). By sector, the most significant measures affect key products in Chinese exports, such as machinery, electrical and chemical products and transport, meaning that tariff barriers have risen notably (see Chart 3). Other countries affected by US tariffs are Russia and Turkey, owing to the importance of their steel and aluminium exports (17% and 13%, respectively, of their total exports to the United States).

The impact of retaliatory measures on US exports is, for the time being, limited. Those adopted by US trading partners involve, for now, a limited proportion of US exports (9% of the total). The products most penalised by the new tariffs include exports to China of electrical machinery and equipment, precision instruments and chemical products (see Chart 4). Also affected, although to a lesser extent, were sales of metal and food products to Canada, Mexico and the EU. Retaliatory action on certain specific agricultural products, such as soy, was very significant, leading to the granting of subsidies to the agricultural sector in the United States.

If the trade negotiations initiated by China and the United States in December do not prosper, the risk of a trade war could reignite. In December 2018, the United States and

Retaliatory measures by the United States' trading partners mainly penalise the electrical equipment and machinery, chemical products, metals and food sectors.



SOURCES: PIIIE, USITC, WTO and own calculations.



China signed a temporary truce in their protectionist escalation and started negotiations to reach a trade agreement that will put an end to the bilateral tensions. If an agreement is not reached, the United States has threatened to raise the current tariffs on €200 billion worth of Chinese goods imports from the current 10% to 25%, and to extend the tariffs to all imports from China. Also unresolved is the investigation by the US Department of Commerce into vehicle imports, the outcome of which has not yet been published, but which could result in tariffs on imported vehicles and auto parts. This could have a significant impact on European exports. The percentage of US imports affected by the new protectionist measures could rise to 38% (see Chart 1). Canada and Mexico – the origin of 35% and 17% of US imported vehicles and auto parts, respectively – could be exempt from these measures under the new version of the free trade treaty between the three countries. The United States-Mexico-Canada Agreement (USMCA) was signed in November and should protect the automotive sector from possible tariff barriers. However, there is still much uncertainty regarding ratification of the USMCA by the US Congress and the possibility of a bilateral agreement being reached with China.

US-EU trade relations

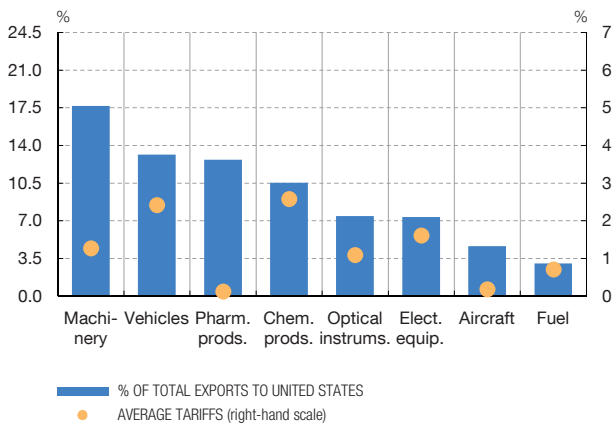
The United States and Europe have very close trade links. The European Union as a whole is the largest export market for US industrial products, and the United States is the EU's largest export market. Vehicle exports to the United States are particularly important for the EU (accounting for 13% of total exports to the US), while aircraft exports to the EU are especially significant for the United States (accounting for 10.6% of the total) (see Chart 5). In some sectors, such as vehicles and machinery, the United States has a considerable bilateral trade deficit.

The trade tariff structure between the two areas is very uneven. European Union tariffs on US imports are quite high for some specific products (see Chart 5), such as vehicles, chemical products and aircraft. This is the argument used by the US administration to defend the imposition of possible offsetting measures.

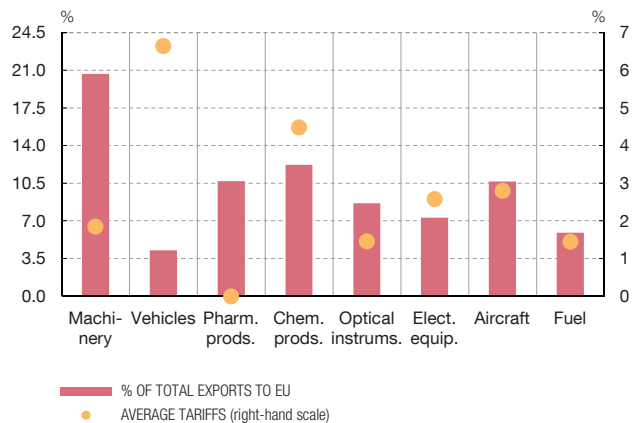
In 2018, the United States and the European Union agreed to progress towards a free trade area; this has led to a temporary truce. The agreement signed in July 2018 aims to eliminate tariff and non-tariff barriers and to prohibit subsidies for industrial goods (excluding cars). The two areas also undertook to work, together with the WTO, to settle

In some of the main bilateral exports, such as machinery, vehicles, chemical products or aircraft, US exports to the EU are subject to higher tariffs than those levied in the United States on European exports.

1 EU: MAIN EXPORTS TO UNITED STATES AND AVERAGE TARIFFS



2 UNITED STATES: MAIN EXPORTS TO EU AND AVERAGE TARIFFS



SOURCES: Eurostat, WTO and own calculations.

a 2017 figures.



Impact of the existing measures and of a possible escalation in protectionism on European economies

the problem of the appropriation of intellectual property rights (in reference to China) and to refrain from adopting protectionist measures while the negotiations are ongoing. In April 2019 the European Commission officially approved the start of the trade talks with the US authorities on the creation of the free trade area. The possible obstacles for achievement of an agreement still include the United States’ demand that the tariff-free area should also include agricultural products, to which the EU is opposed. In addition, official publication of the findings of the investigation into the automotive sector remains pending, along with the US government’s decision in that respect.

To date, the direct impact on EU trade of the protectionist measures adopted by the United States has been only marginal, but high risks persist in the automotive sector. In particular the measures affect steel and aluminium exports to the United States, which account for just 1.7% of total exports to the United States and 0.3% of total extra-EU exports. But if tariffs were levied on the automotive sector, the proportion of exports to the United States affected by protectionist measures would rise to 14.7% (2.9% of total EU exports). As Chart 6 illustrates, exports of vehicles and auto parts to the United States make up a significant proportion of total automotive sector exports in the United Kingdom, Italy and Germany (18%, 14% and 12%, respectively). In other countries, the figure is much lower. In the case of Spain, vehicle exports to the United States account for just 1.7% of total sector exports.

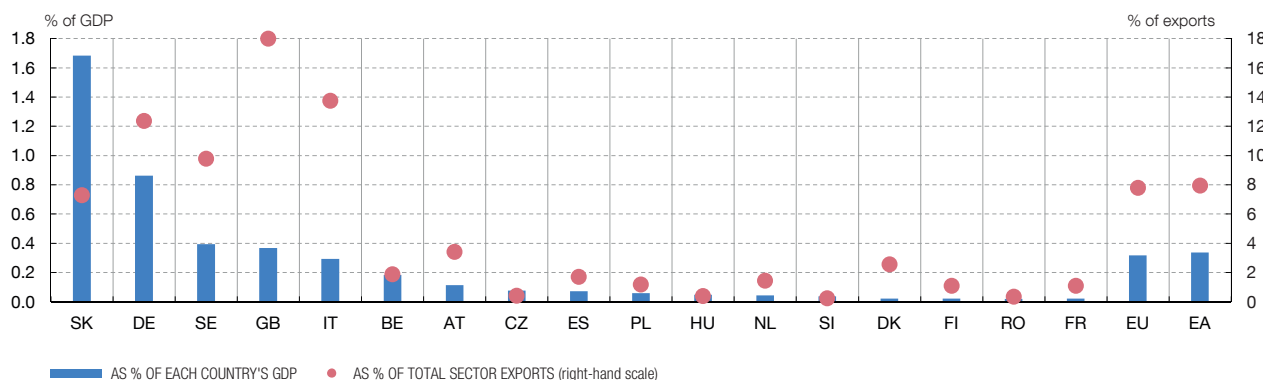
The indirect effects through global value chains would also be limited. The Chinese economic sectors subject to US tariffs do not have a high national value-added content. Indeed, Chinese exports to the United States in these sectors have a high proportion of inputs from other countries, especially from other Asian economies, which means that the effects of US trade tariffs may also spread to those countries.² An analysis performed drawing on the OECD’s statistics on trade in value-added shows that the value added by

² For example, in the electrical equipment sector, less than 50% of the value contained in Chinese exports to the United States is actually produced in China.

EXPORTS OF VEHICLES AND AUTO PARTS TO THE UNITED STATES (a)

CHART 6

For some EU members, exports of vehicles and auto parts to the United States make up a considerable proportion of GDP and of total sector exports, although the differences across countries are very marked.



SOURCES: Eurostat and own calculations.

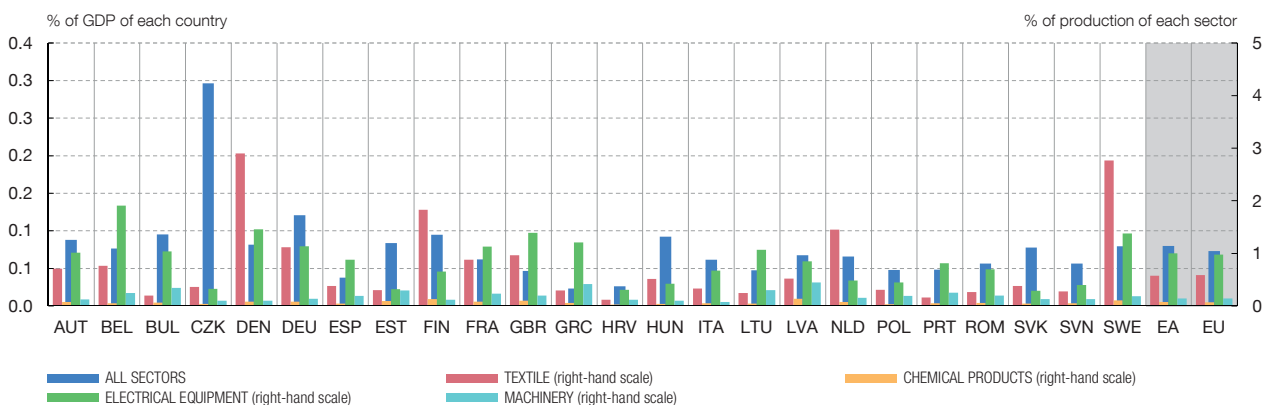
a 2017 figures.



VALUE-ADDED CONTENT IN CHINESE EXPORTS TO THE UNITED STATES (a)

CHART 7

US-China trade tension will foreseeably have a very limited indirect impact (through global value chains) on the EU and the euro area, although certain countries could be more affected at a sectoral level.



SOURCES: TiVa, WEO, Eurostat and own calculations.

a 2015 figures.



the EU or the euro area to Chinese exports to the United States is very limited, less than 0.1% of GDP (see Chart 7). The textile and electrical equipment sectors are those that record the highest share (1% and 3% of total sector output, respectively).³

The simulations made suggest that the tariffs already adopted would have a moderate direct impact on global economic activity. Those made by the IMF using its global general equilibrium model (IMF, 2018) show that the measures currently in force would have a very limited impact on world GDP: a decrease of 0.11% compared with the 2019 baseline scenario and of 0.12% in the long term, although the effects on the United States and

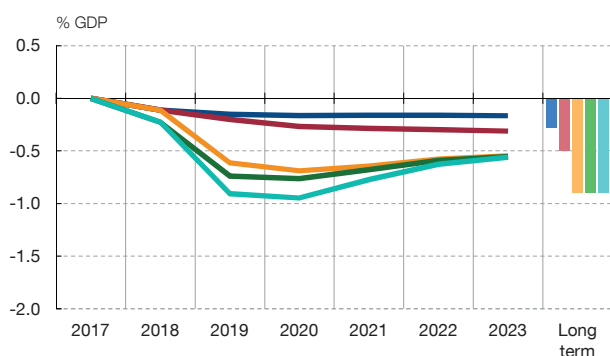
³ The analysis at a disaggregated level excludes Ireland, Malta and Luxembourg owing to measurement problems. As regards the value added contained in US exports to China, the contribution of EU countries is virtually zero (no more than 0.02% of the GDP of each individual economy or of the aggregate total).

IMPACT OF EXISTING AND POSSIBLE ADDITIONAL MEASURES
% GDP deviation from baseline scenario

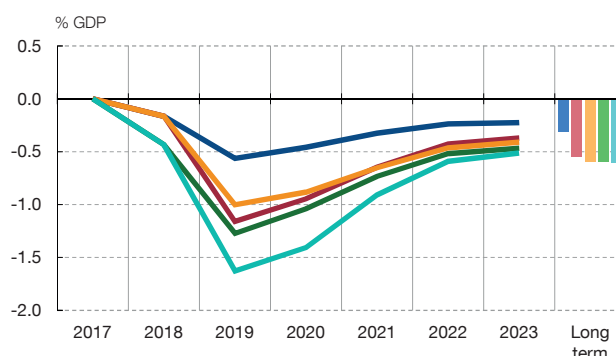
CHART 8

The existing measures will have a minor impact on activity in the main areas. An escalation in tensions could have a more pronounced impact on growth, both through the trade channel and on account of the market reaction.

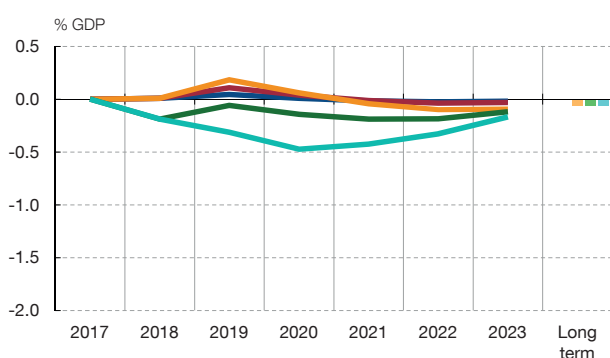
1 UNITED STATES



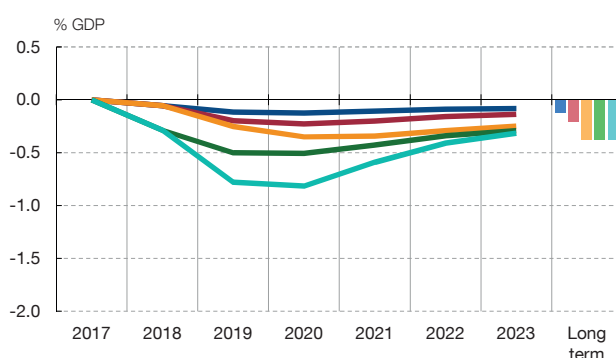
2 CHINA



3 EURO AREA



4 WORLDWIDE



— EXISTING MEASURES
— TOTAL CHINESE IMPORTS WITH REPRISALS
— VEHICLES AND AUTO PARTS WITH REPRISALS
— CONFIDENCE EFFECTS
— MARKET REACTION

— EXISTING MEASURES LONG TERM
— TOTAL CHINESE IMPORTS WITH REPRISALS LONG TERM
— VEHICLES AND AUTO PARTS WITH REPRISALS LONG TERM
— CONFIDENCE EFFECTS LONG TERM
— MARKET REACTION LONG TERM

SOURCE: IMF.

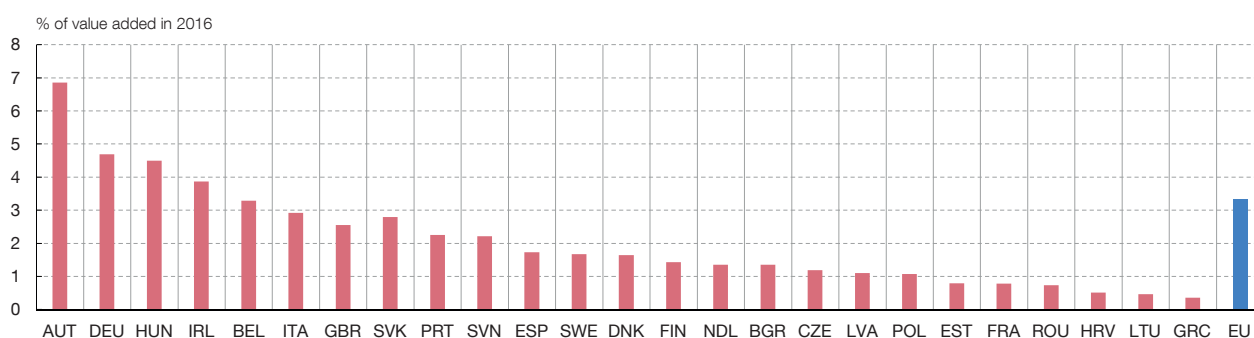


China would be more pronounced (see Chart 8). Although in the short term the existing measures could give a slight boost to European firms' exports to the United States and China in the sectors affected by the bilateral tariffs, the impact on activity in the euro area would be very modest (0.04% in 2019) and would virtually disappear in the long term, once US and Chinese consumers shifted to goods produced nationally.

A similar dynamic would arise if the United States were to extend tariffs to all imports from China and place 25% tariffs on imports of vehicles and auto parts, followed by retaliation by its trading partners. Specifically, these measures would boost activity somewhat in the euro area in the short term (+0.18% in 2019 compared with the baseline scenario), owing to the higher demand for vehicles and other European products from the United States' trading partners affected, which would reduce their imports from the United States in retaliation. In the long term the effect would be slightly negative, shaving 0.06% off euro area GDP.

The drop in business confidence and the adverse reaction of the international financial markets could significantly heighten the adverse effects of any measures adopted or

US tariff barriers on imports of vehicles and auto parts would have a significant impact on the automotive industry of several EU countries.



SOURCES: IFO Institute, Eurostat and own calculations.



announced. Greater uncertainty regarding consumer and investor confidence and the financial markets would amplify the negative effects of the trade measures adopted, both at a global level (-0.8 pp in 2020) and on the individual economies. In the case of the euro area, the negative impact would be limited, even in the short term.

Tariffs on cars could have a significant impact in a sector that is already facing serious challenges stemming from the structural and technological transformation of the industry.

Although it is estimated that the current tariffs and possible additional measures will have a limited impact on aggregate euro area GDP, the effects of possible restrictions on vehicle imports would be more pronounced at the sector level and in certain countries. To investigate these impacts, the IFO Institute analysis (Felbermayr and Steininger, 2019) simulates a 25% US tariff on imports of vehicles and auto parts from all its trading partners, in a general equilibrium trade model that takes into account the European regional value chain structure linked to vehicle production. The findings show that, in the long term, US protectionist measures on vehicle imports could significantly reduce the automotive industry's value added in several European countries (see Chart 9). Austria, Germany and Hungary, where the industry's value added would shrink by 6.9%, 4.7% and 4.5%, respectively, would be among the economies most affected. This figure would be around 3% for the European Union as a whole, which implies that the tariffs on vehicles would have a significant impact at a sectoral level. In Spain the effect would be more limited (1.7%) because although vehicles account for a considerable proportion of total exports of goods (17.3%), exports to the United States account for just a small fraction of that total.

Final comment

The euro area is not, in principle, the main focal point of the Trump administration's protectionist trade policy, which is focused primarily on China, and nor will it be heavily affected by the measures approved, or even by those announced to date. However, these measures could have a greater impact if they are accompanied by more marked effects on uncertainty and confidence. In addition, if the United States were to levy tariffs on the automotive sector, the effects through the European value chains could be more negative than expected, and would in any event severely impact some European countries.

Beyond the immediate macroeconomic effects, the unilateral stance adopted by the Trump administration makes the really crucial objective for correctly channelling future international trade relations more distant. This objective is none other than to adopt a set

of common rules to adapt trade relations to the new reality, not only in view of the growing weight of China in the world economy, but also on account of the technological and structural changes taking place in the production and trade of goods and services worldwide.

9.5.2019.

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