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SWP Comment

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Yes, He Can: Trump Provokes a Trade War

A Clever EU Will Refrain from Further Tariffs but Hold Firm on WTO Rules

Bettina Rudloff

The transatlantic trade dispute is escalating: After the United States (US) introduced additional tariffs on steel and aluminium, hectic negotiations began with the European Union (EU). First, the EU obtained a temporary derogation before increasing tariffs on a long list of particularly symbolic and politically sensitive products, such as orange juice and Harley-Davidson motorcycles. At the same time, the EU, in concert with other states, made the first move in a possible World Trade Organization (WTO) dispute procedure against the US. The US, in the meantime, has signalled the next round by deciding to examine options for tariffs on cars. Existing multinational rules leave only a limited scope for tariff increases, all of which bear the risk of further escalation. It would therefore be wise for the EU not to exhaust this leeway but to keep cool and stay liberal in its approach to trade.

Following the experiences during the world economic crisis of the 1930s — experiences that were also fuelled by spiralling tariffs — the General Agreement on Tariffs and Trade (GATT), a forerunner of today's WTO, came into force in 1948. The participating states agreed on reliable rules for undistorted trade, for example by reducing national tariffs. Moreover, tariffs may only be raised unilaterally up to an agreed tariff ceiling ("bound tariff") without any further requirements. Increases beyond these ceilings follow different rules, depending on the underlying justification.

Limited WTO scope for unilateral increases in tariffs

Rules for increases in tariffs beyond the bound tariffs and other trade restrictions (Table 1, p. 2) can initially be differentiated according to the *justification*, that is, whether measures such as the recent American tariffs on steel and aluminium are aimed at protecting against unfair trade practices of other countries or envisage other objectives. There are also different *procedural guidelines*, such as deadlines. *Reactive tariffs* — used to compensate for disadvantages resulting from justified trade restrictions — are rarely possible. However, the complaint option is always open.



Table 1

WTO scope for unilateral trade restrictions and reaction

Basis GATT article	Measure	Justification, process	Reaction by affected state
General objectives			
■ Balance of payments (Art. XII GATT)	Limitation to quantity or value of imports	Consultation after 1 year	—
■ Exceptions from elimination of quantitative restrictions (Art. XI GATT)	Export- and import restrictions	Special market situations for agricultural and essential products	—
■ General exceptions (Art. XX GATT)	“Necessary” measure	List of objectives (e.g. human, animal and plant health), justification by necessity	—
■ Safeguards (Art. XIX GATT)	Feasible measures, no voluntary export restraints, automatic tariffs for agriculture	Serious injury, provisional protection possible, time limit	Reactive tariffs, 3-year blocking period in special conditions
■ Waiver	Individual exceptions	Majority rules for approvals by WTO states	—
■ National security (Art. XXI GATT)	Information limitation, any measure	Military products, unspecified crisis	—
Safeguards against states’ behaviour			
■ Countervailing dumping and subsidies (“trade defence instruments”) (Art. VI GATT)	Tariff	Proof of damage and correlation, provisional protection possible, time limit	—
■ Retaliation/penalty (Dispute Settlement Understanding)	Tariff	Enforcing a decision on a dispute	—

Dangerous rhetoric of retaliation and penalties

The current transatlantic conflict is essentially about the question of whether the recent US tariffs on steel and aluminium are to be understood as market-based protective tariffs under Article XIX GATT or as tariffs with national security objectives under Article XXI GATT. In any case, neither the American nor the European reactive tariffs are “retaliatory” or “penalty tariffs”. These terms are reserved solely for the WTO dispute system — as a final means of im-

plementing a dispute’s decision. The misuse of the terminology in the public debate suggests self-justice among states. This false impression weakens confidence in the already weakened WTO.

Imminent risk in WTO rules of mixing tariffs and security policy

The national security argument has rarely been used in the past to justify trade restrictions: The EU established tariffs against the former Yugoslavia in the early 1990s. In the 1980s, the US utilised this argument to

justify a trade embargo against Nicaragua. A GATT panel decision at that time did not legally come into effect but stated that, as a commercial body, it could not rule on security issues. In 1996, the Helms-Burton Act under then-President Bill Clinton used the security argument against Cuba, even in relation to third countries trading with Cuba. A relaxation of the measures was achieved in the course of a WTO dispute procedure initiated by the EU. A new panel decision on the national security clause is expected at the end of 2018 in the case of Russia against Ukraine, which justifies import bans under Article XXI GATT. The ruling could bring legal clarity on the interpretation of the national security trade argument for the first time.

EU choosing between plague and cholera

All EU response options presented below are risky: not only for the EU, but also for global trade and other trading partners, and not least for confidence in the WTO.

(1) *The EU could start a WTO dispute.* After the US tariff exemption for European steel and aluminium products ended, the EU began formal WTO consultations with the US on 1 June. Canada, Mexico, and Norway followed soon afterwards. China and India had already begun consultations with the US. If these consultations fail, these states may initiate a formal dispute. All complaining states doubt the rightful justification by Article XIX GATT. Thus, they assume that the US is using market protection as a reason and not national security – this is the only way to justify tariff lists being drawn up as well by the EU as countermeasure (Table 1).

Risk: The arbitration body of the WTO will no longer be able to act from autumn 2019 onwards because the US is blocking the replacement of the appellate judges. This means that no further decisions are possible after a panel decision. How this could turn out is still unclear. So far, the US has based its tariffs on the domestic section

232 of the Trade Expansion Act of 1962, which aims to protect the US from threats to its national security. It could therefore be in line with Article XXI GATT. If a panel accepts the security argument, the EU tariff list would not be WTO-conforming any longer. It is not clear whether the pending ruling in the case of Russia against Ukraine will support America's use of security reasons as justification.

(2) The established *EU tariff* list covers similar products when compared to measures against US steel tariffs in 2003. At that time, however, the administration of George W. Bush referred to an import glut, and thus clearly used Article XIX GATT to justify the American tariffs. A WTO decision allowed the EU to impose retaliatory tariffs. They were not used in the end, as the US abolished its steel tariffs. The current EU tariff list includes nearly 400 – mainly symbolic – products from states governed by the Republican Party with an initial total value of €2.8 billion per year. A second stage for additional reactive duties is envisaged for three years from now, in accordance with Article XIX GATT (Table 1).

Risk: The US could beat the EU with its own weapons. If the US disagrees that the EU is taking countermeasures and sees these as safeguards only to protect its own market, the US can, in turn, react with countermeasures. The tariff spiral would therefore turn even faster. Actually, the US very recently has chosen to challenge the justification of the established reactive tariff lists of the EU, China, Canada, Mexico, and Turkey in mid July by complaining to the WTO. Generally, reactive tariffs are also detrimental to the implementing importer, such as the EU: Whether there will be subsequent price increases for consumers depends on supply alternatives, which are hardly available for genuine American products such as Harley-Davidsons.

(3) Any affected country may *impose its own safeguards* on aluminium and steel under Article XIX GATT to compensate for the damage caused by initiated safeguards. The US tariffs can divert products that were previously imported to the US into the EU

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instead. Actually, the EU just decided at the end of July to define additional tariffs of 25 per cent on steel imports, with some exceptions. They are following the rules for provisional protection according to GATT XIX for a maximum of 200 days, depending on the actual increase in imports (Table 1).

Risk: The US could challenge the import injury. Moreover, the EU may lose strategically important coalition partners in the conflict with the US, such as China, Brazil, or Russia, due to the disadvantages it brings to them with these tariffs being applicable to all steel-trading partners. These countries may react by their own tariff lists – so this option could also further drive the escalation of tariffs.

(4) *Compromises* already emerged in the public debate during the phase of the exception being applied to European suppliers: Options discussed were voluntary export restraints, which are, however, excluded by Article XIX GATT. A “TTIP light”, that is, the reduction of EU tariffs for individual products such as cars, is also being considered.

Risk: Any exemption for individual partners can be undermined and challenged under the WTO's basic idea of general trade justice under the “most favoured nation” approach. Exceptions can also offer black-mail potential for new concessions. A complete zero-tariff policy for all products and all countries would be possible and could bring the offensively trade-pacifist EU off of every trade-related firing line. However, it has the disadvantage of limiting the scope for future liberalisation negotiations. In addition, interests also differ within the EU: Although an offer for the industrial sector within the framework of a “TTIP light” is conceivable for Germany, this does not seem to be an option for France.

5) The EU could also use *non-tariff measures*, such as tightened labelling requirements, to make it more difficult to import American products.

Risk: Although these measures are, in principle, more flexible than tariffs, they

cannot be presented as a direct political reaction to US behaviour. In addition, they too can be challenged or can lead to a “standard escalation” comparable to that of tariffs.

The smart move for the EU: No tit for tat

Past conflicts have often reached the limits of formal rules when there were extreme differences in interests: For example, in the hormone case between the EU and the US/Canada, the ruling allowed for retaliatory tariffs to be imposed on EU products. However, this last means of the WTO dispute failed: For 10 years, the EU was subject to retaliation in the form of about \$130 million per year in trade volume because, despite the WTO ruling, it maintained the ban on importing beef produced using hormones. Ongoing negotiations finally brought a solution: The EU even maintained the ban on beef containing hormones, but it offered tariff incentives for hormone-free meat.

With patience, solutions can sometimes be found. Also today, the EU should minimise their exposure as much as possible and play for time while continually making offers for dialogue with Trump. Domestic reactions to US policy, such as Harley-Davidson's relocation plan, can play into the EU's hands, as can new EU trade agreements, like the one with Japan, which isolates the US as trade partner. In playing for time, the EU should refrain from further countermeasures, even if the US imposes tariffs on foreign cars. This is the only way to end the already started escalation, which also depends on the EU's behaviour. Better to withstand short-term losses than a loss of confidence in the WTO's rules. This could end in trade anarchy, which the world has already experienced and led to the creation of GATT.

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