MACROECONOMIC IMPACT
OF THE
STEEL TARIFFS

Presented to the

UNITED STATES INTERNATIONAL TRADE COMMISSION

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SELECTED MILESTONES REGARDING FREE MARKET IDEAS AND INTERNATIONAL TRADE

POSITIVE		NEGATIVE	
1776	Adam Smith: Wealth of Nations	**1781**	Articles of Confederation
1789	U.S. Constitution Article I, Section 9	**1848**	Karl Marx: Communist Manifesto Assails Free Markets
1817	David Ricardo, Principles of the Political Economy	**1878**	Bismarck "Iron & Rye" Laws
1846	Great Britain Repeals "Corn Laws"	**1914**	World War I
1934	Reciprocal Trade Agreements	**1930**	Smoot Hawley Tariff/Great Depression
1944	Bretton Woods	**1939**	World War II
1946	President Truman Repeals Wage & Price Controls	**1947**	Cold War Begins
1947	General Agreement on Tariffs & Trade	**1971**	President Nixon Wage & Price Controls
1981	President Reagan Repeals Wage & Price Controls	**1978**	President Carter Wage & Price Controls
1990's	NAFTA, WTO, GATT Cold War Ends	**2002**	American Steel & Lumber Tariffs

MACROECONOMIC ACTIONS

LAG EFFECT

- Tax Cuts EGTRRA 2001-2010
  - $1.35 trillion, $135 billion/year
- Interest Rate Cuts 2001-2002
  - 5.25% decrease in Fed Funds Rate

CYCLICAL ISSUES

- Internet Bubble Burst
- Corporate Fraud
- Recession 2001
- September 11th Attacks
- Poor Corporate Earnings

IMMEDIATE EFFECT

- Oil Price Fluctuations
- Low Dollar – Imported Inflation
- Tariffs

STRUCTURAL ISSUES

- Tariffs
- Crop Subsidies

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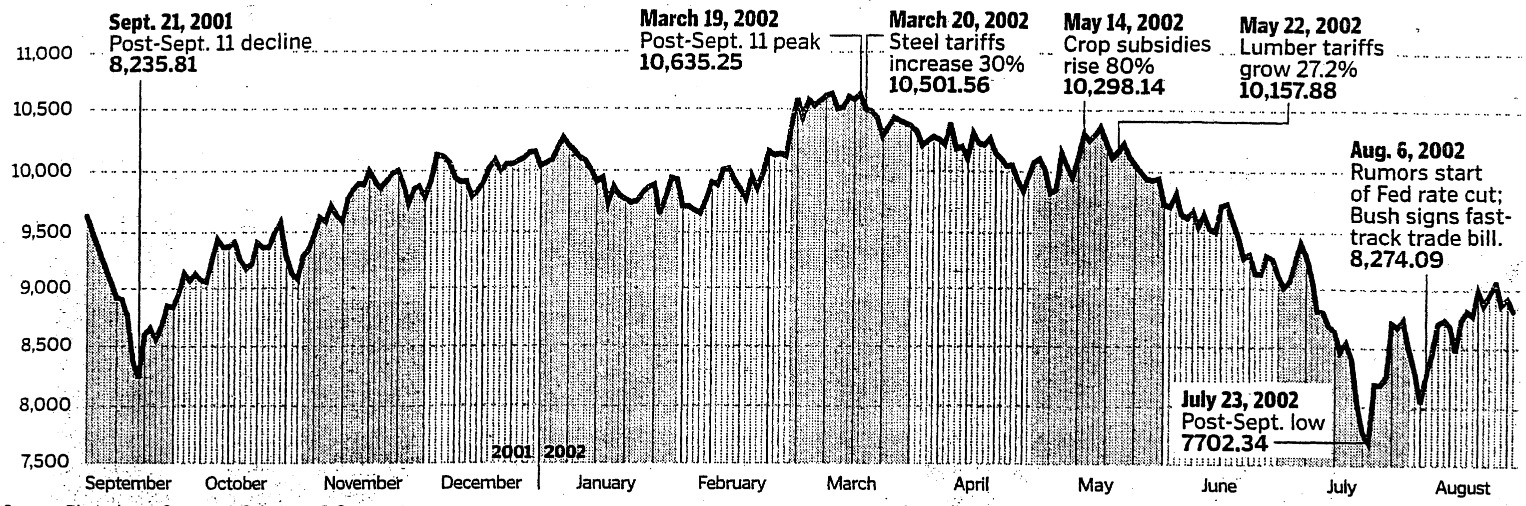
THE DETROIT NEWS 9/3/2002 P. A9 COMMENTARY

Economic policy changes explain stock market fluctuations

After the Dow Jones Industial Average hit a post-Sept. 11 high of 10,635.25 on March 19, it fell after news of increases in tariff penalties and crop subsidies. The market started rebounding after President Bush received fast-track authority to negotiate trade agreements and rumors started about a possible Federal Reserve rate cut.



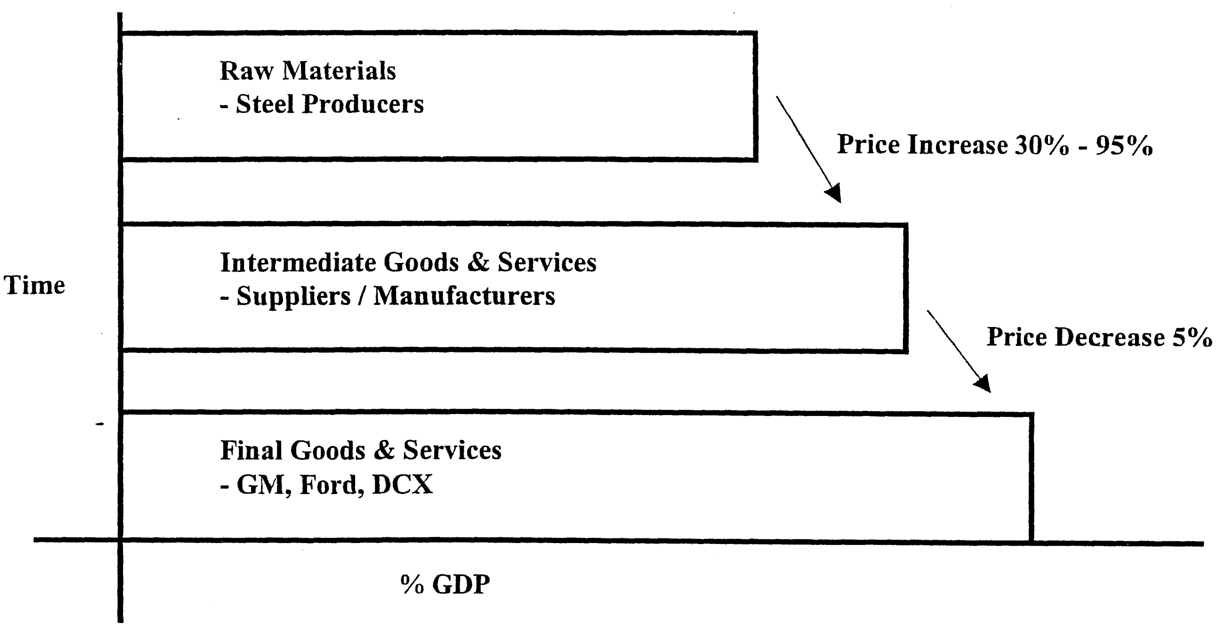
Source: Bloomberg, Gregory J. Schwartz & Co.

The Detroit News

Trade moves spur economic doubts

By David R. Breuhan

THE STRUCTURE OF PRODUCTION



Since GM, Ford and DCX as well as other "Tier One" suppliers have global purchasing power, they can avoid the domestic suppliers cost increase by ordering parts from China and Mexico, bypassing the affects of the tariffs. Since January 2002, the intermediate sector has paid more than $15,000,000 for every 100,000 net tons of hot rolled steel. Unable to recapture this increase, the entire manufacturing sector is slowly imploding. Further, there are no tariff exemptions for domestic steel, which has also increased more than 30%, since there is no competition from abroad.

EXPLAINING MARKET REACTION

Commodity Markets: Anticipates Shortages

Steel: Following December 7, 2001 recommendations by the International Trade Commission (ITC) to President Bush, steel prices began rising. Hot rolled steel increases from $210 per net ton to $260 per net ton in March 2002. July prices reached $410, settling at $400. The price is now dropping due to increased supply and decreased demand.

Lumber: The May 22, 2002 lumber tariff of 27.2% has been easily absorbed by the housing market. If a 3,000 square foot house increased in price by $1,500 - $3,000, the additional cost is simply added to the mortgage, effecting the economy very little. The end user is not visibly effected.

Automobile Industry: Steel tariffs may have increased the price of a car by $100. This tariff is being absorbed entirely by the intermediate sector. Its effects on manufacturing is equivalent to doubling the amount of a homeowner's mortgage, but not doubling the amount of their paycheck. Once again: the end user is not effected.

Equity Markets: The market chose to ignore the potential effects of the ITC recommendation, as well as President Bush's March 5, 2002 executive order prior to the March 20 implementation. Given America's history on trade, the market assumed that this issue would be resolved. Markets began dropping on March 20, 2002. Combined with other factors, reduced future earnings will decrease the present value of stocks.

S&P 500 Market Cap:

Date	Price	Market Cap (in millions)
03/19/2002	1,170.286	$10,709,845
05/23/2003	933.224	8,618,505
Difference	237.062	$2,091,340
	(20.26%)	$2.091 Trillion

Source: Standard & Poor's

VITAL STATISTICS

SELECTED MONTHLY STEEL PRICES
DECEMBER 2001 – NOVEMBER 2002

Items:	2001 Dec	2002 Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov
Hot-rolled steel sheet (Midwest, $/ton)	210	220	230	260	290	320	340	400	380	380	370	345
Cold-rolled steel sheet (Midwest, $/ton)	300	310	320	370	380	410	435	525	525	500	480	465
HD galvanized steel sheet (Midwest, $/ton)	320	330	330	380	415	425	445	535	535	525	510	500

Source: Purchasing, November 27, 2002

MANUFACTURING JOB LOSSES
(SEASONALLY ADJUSTED)

March 2002	**Employment**	**16,822,000**
March 2003	**Employment**	**16,346,000**
	Job Losses	**(476,000)**

STEEL PRODUCTS & BLAST FURNACES
(SEASONALLY ADJUSTED)

March 2002	**Employment**	**188,000**
March 2003	**Employment**	**184,000**
	Job Losses	**(4,000)**

Source: U.S. Department of Labor, Bureau of Labor Statistics

More steel consuming jobs lost in 2002 than exist in the entire steel producing industry.
Source: The Wall Street Journal, 2/25/03, p. A14

TOTAL HOT ROLLED SHEET SHIPPED IN 2001: 20,497,873 net tons/18,595,549 metric tons
Increase of price/ton can result in overpayment of billions of dollars annually.

Source: U.S. Department of Commerce, Current Industrial Reports MA 331B(01)-1, table 3a.

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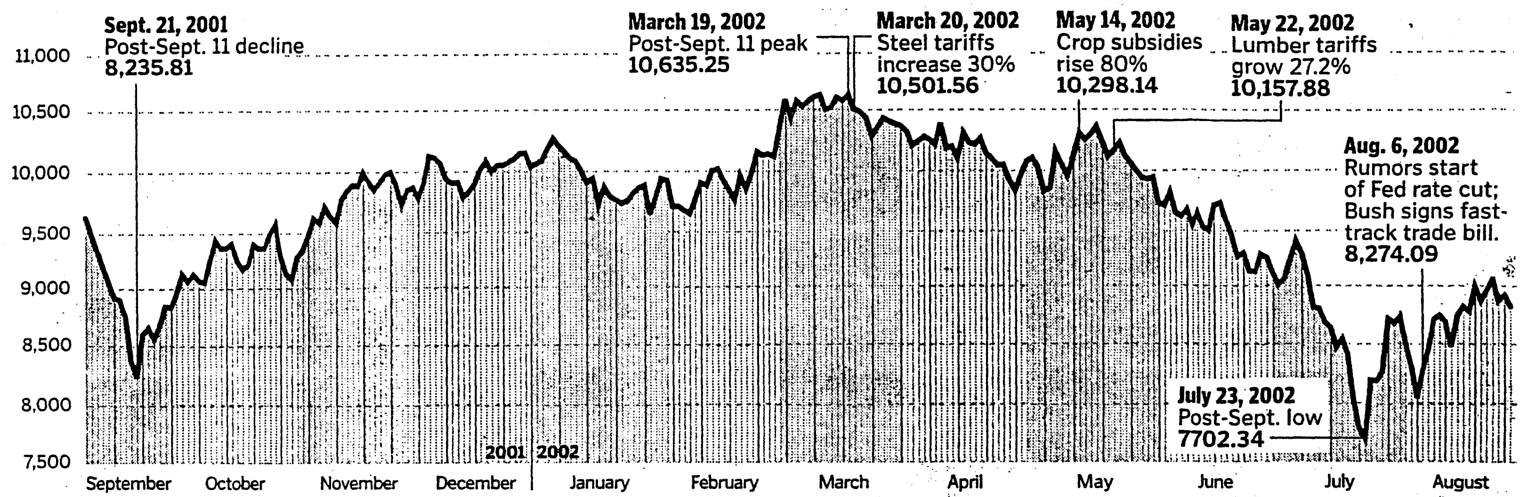

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Trade moves spur economic doubts

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Questions about earnings, corporate governance and the war against terrorism have caused the decline in the stock market as well as contributed to its recent volatility. What many observers have not yet noticed is that questions about the economy and current market difficulties are more due to government policies than the cyclical problems normally associated with the "bust" at the end of a business cycle.

In particular, the recent trade protection imposed by the president and Congress may be responsible for the nation's economic uncertainty. The imposition several months ago of steel and lumber tariffs as well as the passage of the farm bill with its huge subsidies sent a message to our trading partners that the United States may be altering its policy to open global markets.

Tariffs are simply an international tax, which are an obstacle to exchange. Since we rely on others to make many goods and services that can only be produced abroad, when tariffs are raised, consumers pay higher prices. One third of the U.S. economy, the manufacturing and building sectors, cannot possibly absorb a price increase of roughly 30 percent in two months without adverse consequences.

Protectionism affects both the individual and business. Higher tariffs translate into higher prices, leaving people with less money to buy products or services. Higher costs result in lower corporate profits, which decrease stock prices. In the end, protectionism hurts the economy.

Consider some economic signals. The Dow Jones Industrial Average hit a recent peak of 10,635.25 on March 19. The next day, penalty steel tariffs took effect. Two days later, the United States announced it would impose an average 27.2 percent tariff on softwood lumber imported from Canada, which would take effect on May 22. And on May 14, new farm subsidies became law.

Earnings drive the market, and trade supports higher earnings. If raw material prices are higher, profits are lower and the stock market will adjust today for decreased earnings in the future.

Since then, the market has hit a low of 7702, bouncing back recently to around 8660, but is still trading far below the prior high. Despite the lowest interest rates in 40 years, housing starts recently were reported slower than expected for the second month in a row — which is not surprising when wood prices are being pushed higher by the softwood tariff.

The greatest danger of protectionism is that we invite retaliation from other nations. Overseas tariffs make it more difficult for the United States to export its goods and services, decreasing the endangering jobs at home.

By attempting to win votes from rank-and-file union members and farmers, the president and Congress ignore the retaliatory effects of other nations' tariffs on the rest of us. Farmers, steel workers and employees of the lumber industry pay higher prices at the register just as the rest of us do. How do you expect manufacturers to pass along a price increase in steel when their contracts with their customers have already been signed?

Consumers and producers shop globally. Overcharge them, and they will buy elsewhere. If other nations pursue such a policy, their citizens will suffer.

Fortunately, the European Union has delayed retaliating for the steel tariffs. And President Bush recently announced more exemptions to the penalty steel tax, which will reduce trade tensions.

Increasing agricultural subsidies won't help either. They will create a price floor, generating too much supply of farm products and not enough demand in America. Overseas, an increase in U.S. crop production will depress foreign agricultural markets, creating less profit for farmers. In mainly agrarian countries, economic disruption can lead to increased political tension.

The Bush administration has received the fast-track authority it wanted to negotiate trade deals with other gress, but only can be approved or rejected as negotiated. But what nations want to bargain with a country that is raising its trade barriers? Since the Smoot Hawley tariff of 1930, most tariffs have decreased to 3 to 4 percent from 60 percent, thanks to various free trade agreements. Now we have turned back the clock on trade. Our allies are furious. Worse, we look like hypocrites — and we expect help in the war on terror?

There are alternatives to tariffs. The Bush administration could grant tax abatements or credits to the steel and lumber industries. With the Federal Reserve's funds rate at 1.75 percent, how about a 10-year low-interest loan with a balloon payment, similar to the Chrysler bailout of the early 1980s? There is no trade disruption with this choice. The federal government also should help lower the cost of doing business.

It is ironic that the same administration that wanted Americans to keep more of our money through tax cuts has taken some of it back through the higher prices caused by protectionism. The markets are sending the Bush administration a signal that its trade policies created economic uncertainty. The advice needs to be recognized and embraced.

David R. Breuhan is a portfolio manager with the Bloomfield Hills investment firm of Gregory J. Schwartz & Co.

To the Editor

Regarding David Hale's commentary, it is amazing that we have any growth at all. In addition to all of his macroeconomic "shocks," he omitted the devastating impact of the steel and lumber tariffs imposed by the Bush administration on March 20 and May 22, respectively. In order to win passage of Fast Track Trade authority, the White House won votes by assuring that tariffs would be imposed. The legislation passed 215-214. However, the economic effects have been devastating, especially in the manufacturing sector. The market didn't like the tariffs, either, peaking on March 19. Oh, you can talk about the Internet bubble, corporate fraud, poor earnings, and the war on terror, but nothing will kill a recovery like an international tax on trade, which increases transaction costs that are ultimately borne by the consumer.

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