

No. 198

Tariffs on Cars*

The escalation of the conflict between the USA and its trade partners seems inexorable. In May 2018 Donald Trump commissioned the US Department of Commerce to investigate whether car imports constitute a threat to US national security. The US Department of Commerce points out that the share of cars imported into the US market has risen from 32 percent to 48 percent over the last 20 years. Between 1990 and 2017 the number of jobs in the US automotive industry fell by 22 percent. US firms accounted for only 20 percent of global research and development expenditure in the automotive sector, and for just 7 percent of car part production. It therefore seems very likely that the US government will argue that car imports pose a threat to national security. That is, of course, no more than an excuse to impose tariffs.

Who would be affected by the import tariffs? Donald Trump first called for higher taxes on all the Mercedes-Benz and BMWs sold in the USA way back in the 1990s. So car tariffs primarily seem to be directed against Germany. In fact, however, other countries will be hit harder by the tariffs for two reasons: firstly, the majority of car imports into the USA do not come from Germany, but from Mexico, Canada and Japan. In 2017 Mexico cars worth a total of 46 billion US dollars were imported by the USA, followed by Canada with 42 billion US dollars and Japan with 40 billion US dollars. These three countries together account for two thirds of car exports to the USA. They are followed by Germany, trailing a long way behind in fourth place, which exports a total of 20 billion US dollars-worth of cars to the USA. Of course, there may always be tariff exemptions for individual countries. Germany's surprisingly low share of imports is partly due to the fact that Volkswagen, BMW and Daimler also produce a share of their cars sold in the USA domestically. Secondly, Audi, BMW and Mercedes-Benz buyers can be expected to react less sensitively to price increases than consumers in the mass market. This would suggest that German manufacturers could pass on a larger share of punitive tariffs to their buyers than producers from other countries.

US punitive tariffs on cars would nevertheless be a burden on the German economy. Calculations by ifo researcher Gabriel Felbermayr show that a 25 percent US punitive tariff on cars would reduce Germany's gross domestic product by 5 billion euros.

In the debate over US punitive tariffs, it is often argued that Donald Trump's goal is to divide Europe. Germany is by far the biggest car exporter to the USA among all EU states. The next largest European car exporter is Britain, which is leaving the EU and does not count, followed by Italy with an export volume of almost 5 billion US dollars. Many expect that Germany's EU partners may refuse to take retaliatory measures. Only Germany would suffer from US auto tariffs, while everyone would have to bear the costs of retaliatory measures. This assumption overlooks the fact that German car exports include a large volume of intermediate inputs provided by car component suppliers that are largely

based in Italy, France, Austria and the Visegrád countries. In Hungary, for example, losses from car tariffs measured as a percentage of Hungary's gross domestic product would be even higher than in Germany.

What is the right response to the US threats of car tariffs? German car manufacturers have now suggested getting rid of car tariffs altogether in transatlantic trade, instead of introducing new tariffs. This would be desirable in principle, but given the trade imbalance, it is unlikely that the USA would agree to a reduction in tariffs that was only limited to cars. Any such agreement would also violate GATT rules. The most-favoured-nation-clause would demand that all countries should benefit from the reduction in tariffs. Article 24 of the GATT agreement only allows for divergences from this rule as part of free trade agreements that cover "the majority of trade" between two countries, and not just cars.

If the US does actually decide to levy punitive tariffs on cars, it is important that the EU shows unity. This is not self-evident, despite cross border links in the automotive industry. At the last G7 Summit Italy's government, for example, departed from the stance adopted by the other EU countries in discussing the EU's relations with Russia. The EU should take retaliatory measures and apply equally high retaliatory tariffs on US exports to Europe. It is particularly important to avoid giving the impression in US domestic political debates that Trump's protectionism has no cost for the USA.

Another aspect is important: More cars from Japan and other countries can be expected to arrive in European markets. The EU should not react with tit-for-tat protectionist measures, as this would merely lead to an escalation in the trade war. If the US wishes to isolate itself from world trade, then we cannot stop it from doing so. But we should not allow protectionism to spread any further.

* Published under the title "Germany would not be the main victim of Trump's car tariffs", *Euractiv*, 10 July 2018 and in German under the title "Die Angst vor der nächsten Eskalationsstufe", *WirtschaftsWoche*, 29 June 2018, p. 33.