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Trump's tariffs will hurt trade, and trade is a good thing -- really

By John Cochrane

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In a remarkable achievement, President Trump has united the nation's economists by proposing tariffs on imported steel and aluminum, tariffs designed to reduce imports of those goods. The consensus opinion is this: Tariffs are bad for the economy. Tariffs on raw materials, produced by machine-intensive dirty declining industries are worse. Trade is good.

Trade *is* good. Why? Follow the money. If China sells us, say, a solar panel, what does it do with the dollars? There is only one thing to do with dollars — buy American goods, invest in America, or buy our government debt. Oh, and we also get a nice cheap solar panel.

China might use the dollars to buy, say, wheat from Australia, so it looks like China sells us more than we sell them. But then Australia must use the dollars here in America. Dollars always come home to roost. So how much more one country sells us than we sell them — the "bilateral trade deficit" — really is pretty meaningless.

The rest of the world sells us more than we sell them. But the rest of the world uses every cent of the extra dollars it gets from that trade to invest in the U.S. and to buy our government bonds. If we sell the whole world exactly as much as they sell us every year — in other words, if there were no overall U.S. trade deficit — we're the ones who would have to start saving much larger amounts of our incomes in order to invest in U.S. companies, give mortgages to people to buy houses, and to fund the governments' $1 trillion deficits.

Tariffs, like all protection from competition, are great for the protected business and its workers, at least for a while.

Think of it this way: You run a huge "trade deficit" with the grocery store. Why not grow your own food? Well, you're not very good at growing food. And if you do, the grocer will not have money to buy what you make, or to give to the bank to fund your mortgage.

So, trade is good. And tariffs? Tariffs are not good. Tariffs on steel hurt businesses that use steel, especially those that compete with imported products made of steel. Tariffs hurt consumers, who pay more for steel-using products. But perhaps the greatest damage is to the steel industry itself. Tariffs, like all protection, shield the industry from competition. And industries shielded from competition do not innovate, do not cut costs, do not make better products. Only when the Big Three faced import competition did they start to make better cars, and cut costs.

If it is good for each country to protect its businesses with tariffs, then it is good for each state to do the same, i.e. California should keep out those cheap Arizona surfboards. A key to U.S. prosperity is precisely our Constitution's firm ban on state politicians' desire to please local industries with protection. Until the EU came along, the U.S. was the world's largest free trade area. Hint: Bigger is better.

Why is this so hard to understand? Tariffs, like all protection from competition, are great for the protected business and its workers, at least for a while. If you're a practical businessperson you think the way to get the economy going is to just to replicate for the economy what is good for your business, and hand out protection to everyone. But protection only helps one business at the expense of all the others, and at the expense of consumers, and the damage is worse than the gain. What is good for an individual business is not good, scaled up, for the economy as a whole. Business people and bankers turned policy makers miss that.

Tariffs, like other protections, also help visible, large, and politically powerful constituencies. The larger pain is spread throughout the economy, in ways most of us may not even notice in day-to-day living. But it adds up.

Some of the blame belongs to Congress. The trade laws invite protection. The standard for protection is only that the industry is hurt. Imagine if United Airlines could demand that Southwest pay tariffs – an extra tax at an airport – and in order to do so United needs only to show that Southwest might hurt United's profits.

The "national security" clause under which the Trump administration is acting is weaker still. Even the defense department doesn't want this tariff!

We pass populist laws, and then count on administrations not to enforce them. Well, President Trump may help here too, by acting on silly laws and forcing Congress to pass sane laws.

Perhaps some of the blame belongs to economists as well. The words "deficit" and "imbalance" make it sound like something is wrong with trade.

Tariffs do have one thing going for them however – they're better than quotas! With a tariff, at least we can measure and limit the damage — steel will be 25 percent too expensive. But you can still buy it when you need it. Under a quota, in which countries are only allowed to sell a certain amount, the damage can be much larger and you never even know.

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