Sandra Cook
Economic Institutions
23 April, 2023

The Truth About Tariffs

"What protectionism teaches us, is to do to ourselves in time of peace what enemies seek to do to us in time of war" (Hooper).

These are the words of Henry George in his 1886 novel, *Protection or Free Trade.* As old as this text is, the philosophy behind it is still applicable today.

Henry believed in the power of free trade and was adamantly against the implementation of tariffs on foreign imports. He presented a clear and compelling argument on the economic standpoint that tariffs usually do more harm than good.

When the US imposes tariffs on imports from foreign countries, for whatever economic or political reason, it places a tax on the American consumer - often without their realization. The irony is that many of those consumers argue vehemently in favor of tariffs, under the false belief that they protect US jobs and benefit the US economy.

It is important to address the common arguments in favor of tariffs and dismantle the logic behind them.

Politicians and voters on both sides of the political spectrum assume tariffs can be beneficial when utilized to punish a foreign nation. This was a common line of thinking during the Trump Administrations' plans to build the wall. He and his supporters wanted to reprimand Mexico for failing to stop the flow of Central American immigrants into the US.

What could go wrong with building a wall and making Mexico pay for it?

Well, it turns out the answer is a lot.

By implementing a tax on Mexican imports, Trump raised the price of these goods. Consequently, domestic US companies were forced to raise their prices in order to counteract the increased input costs, whilst still maintaining profit levels. These costs passed on to the US consumer during the sale of the finished goods, decreasing the demand for their product, raising the cost of living, and eventually resulting in the layoffs of thousands of American workers (Francois).

Perhaps a more significant argument in favor of tariffs is the protection of domestic industries and jobs?

With the exception of national security, there are few to no industries worth shielding from the progressive effects of free trade.

Bastiat's Candle Maker's satire against protectionist tariffs cleverly reveals the false logic behind this line of thinking.

Imagine the government were to insist that its citizens block out all the light from the sun during the day. People would be forced to close their windows, skylights, shutters, curtains, and blinds in order to protect the manufacturers of candles (as well as lanterns, street lamps, extinguishers, alcohol, and everything else connected to lighting) against the "unfair competition from the sun" (Beattie).

The moral of this story is that rational consumers would rally against being forced to pay for light they could get for free without government intervention. The same concept applies to goods that consumers could buy at a fraction of the cost if free trade were to run unfettered.

Comparably, using tariffs to force consumers to pay for expensive domestic goods, when cheaper foreign imports are possible, benefits American producers - but costs everyone else.

Instead of protecting these industries, the government should invest the money into industries where they have a comparative advantage.

When protectionist policies cater towards domestically produced goods, there is a misallocation of resources. The ability of goods to be produced at a lower cost elsewhere reflects a glaring inefficiency in the economy, and is a significant reason so many economists oppose tariffs.

American Austrian Economist Walter Block understood this concept when he stated, "Protectionism is a misnomer. The only people protected by tariffs, quotas, and trade restrictions are those engaged in uneconomic and wasteful activity. Free trade is the only philosophy compatible with international peace and prosperity" (Block).

There is a misconception that an excess of imports results in unemployment because domestic employees are unable to compete with foreign workers who have comparative advantage. The public believes that we need trade barriers to protect these American workers and prevent such a burden on the economy.

However, the truth is exactly the opposite.

When foreign countries sell their goods freely on American soil, they are paid in American currency. They use this increase in purchasing power for other American products, thus increasing the level of exports, and funding for American companies.

Jobs that are promoted, or "saved" by way of import barriers, have a tendency to be offset by the number of jobs that are lost due to decreased exports. Not to mention, this also leads to an inefficient utilization of resources. If every nation enforced trade agreements that balanced exports and imports, there would be fewer gains from trade because resources

would not flow to areas with the most productivity. “Free trade within America fosters prosperity, and so too does free trade among nations” (Carbaugh).

Looking back in history, it is easy to understand where this line of thinking regarding exports and imports stemmed from.

After globalization developed in the 15th century, European nations began to view wealth as static. They considered it a zero-sum game.

As a result, these countries attempted to accumulate as much wealth as possible by maximizing their exports and minimizing their imports. They advocated for government tariffs and quotas in order to establish themselves in this position.

On the surface, this seems like a logical way of thinking. However, Scottish economist David Hume’s price-specie-flow doctrine soon proved this false. He discovered that “a favorable trade balance is possible only in the short run, for over time it would automatically be eliminated” (Carbaugh).

With an increase in cash flow, the country's prices increase, incentivizing citizens to buy more imports, and lowering the amount of exports. Thus, the trade surplus will never last.

Despite David proving them false, a version of mercantilism still exists today, wherein its believers insist that exports are beneficial because they fuel domestic jobs, and imports are bad because they create unemployment.

“Those who fail to learn from history are doomed to repeat it” (Churchill).

One of the most damning pieces of evidence against tariffs lies in the Smoot-Hawley Tariff Act of 1930.

Implemented during the Great Depression, this act was created to protect American businesses and farmers by raising the average tariff by a whopping 20%. (Britannica) Of course, the act produced very little of the intended effect.

Instead, despite over 1,000 economists adamantly opposing the legislation, President Hoover signed it into law, resulting in a complete disaster for the American economy. This act prompted retaliation from foreign governments, triggered similar beggar-thy-neighbor policies, froze international trade, and may have even contributed to the rise of political extremism.

To quote the American government itself, the Smoot-Hawley Tariff was “among the most catastrophic acts in congressional history” (Senate).

The passing of this Act, and similar tariff acts since then, demonstrates the misfortune of tariffs.

The dilemma policymakers must face is that, on one hand, they need to appeal to the needs of the voting public, whose main goal is to protect short-term interests such as income and employment.

On the other hand, they know that free trade leads to greater global efficiency in the long run.

The costs of free trade are immediately visible and concentrated, whereas the benefits of free trade are widespread and aren't realized until years down the road (Carbaugh). On the surface, tariffs appear to be created with only the best intentions at heart - to save American jobs and protect the nation. However, the truth is that there are far more unintended consequences that hurt the American economy and its citizens in the long run.

Tariffs produce huge inefficiencies within the market.

The Ford Motor Company provides a perfect example for this phenomenon. In the 1960's, President Lyndon Johnson passed a 25% tariff on imports of foreign trucks and vans. Realizing that these tariffs would severely impact their profits, Ford devised a plan to avoid them and still satisfy demand. Several times a month, Ford imported wagons and cars (which have a much lower tariff rate of 2.5%) and took them to a processing facility where they revamped the wagons into vans for sale in the US. This process of ripping out components of the vehicle and replacing them with new ones was incredibly wasteful, and yet it complied with the letter of the tariff law, saving Ford millions of dollars. Without the tariff, Ford could have simply imported the trucks and vans and avoided this entire strenuous process. (Carbaugh)

Another reason tariffs are so unseemly is that they impose the most cost burden on low-income consumers.

The highest tariffs are applied to products that are low quality, such as shoes and clothing. (Carbaugh) The biggest contributor to this regressive tariff effect is tobacco, which is taxed up to 90% and which is bought primarily by low-earners.

A household that earns $5000-10000 annually has a tariff impact of approximately 13.95%. Meanwhile a household that earns $150,000+ annually only contributes 5.24%. (Moran) This means low-income consumers pay more than twice the amount of tariffs than high-income consumers.

Despite how it may seem, tariffs are not pure evil.

There are circumstances in which they can and should be implemented. The most significant example of this is the preservation of national security.

Section 232 of the Trade Expansion Act of 1962 authorizes the president to impose tariffs when a certain product is "being imported into the United States in such quantities or under such circumstances as to threaten to impair national security" (Lincicome).

The most pertinent example of this is the steel and aluminum industries, whose product is used by auto companies, weapons manufacturers, construction companies, and energy producers. Tariffs on steel help protect domestic producers from competition and prevent the US from relying on foreign imports for such vital products.

In the event of another war, the US would want to have a reliable way to continue production, especially if one of our import-heavy countries becomes the enemy.

Using tariffs in this one respect allows both free trade and the safety of the nation to coexist.

Though infrequently used in the past, Section 232 was a favored trade tool of the Trump administration, which was responsible for nearly a quarter of all Section 232 investigations initiated since 1962.

While Congress has constitutional authority over trade policy, Section 232 gives the president broad discretion to enact protectionist measures in the name of national security.

Of course, the issue of which industries are essential to national security is contestable.

Many producers will argue that their product is vital to the safety of the nation, when in reality it would be better subjected to the free market. There is even some debate over whether the steel and aluminum tariffs are actually essential to national security.

Keep in mind that protecting these industries still comes at a cost to the US consumer, foreign relations, and low-income households.

The final reason tariffs are implemented on imports is to generate revenue for the US government.

When the concept of removing such tariffs is brought up, proponents argue that the income is necessary for building public infrastructure and funding national projects. In reality however, tariffs only generate about 1.2% of the country's total revenue. This is not enough to justify the enormous unrealized cost of tariffs.

Henry George’s quote regarding protectionist policies demonstrates how tariffs only serve to shoot their users in the foot.

When the US wants to punish a foreign nation for human rights violations, unsanctioned nuclear weapons testing, or other political machinations, they impose import tariffs to make their producers suffer.

However these policies usually backfire on American consumers.

Since these costs are widely dispersed, the average citizen regretfully won't notice, and will continue to advocate for more.

This is a dangerous path.

The more the United States seeks to influence foreign markets through tariffs, the more it cripples its own economy. While nothing is black and white, most economists will agree that free trade is the best policy, and protectionism should be avoided unless direly necessary.

"It is no crime to be ignorant of economics, which is, after all, a specialized discipline and one that most people consider to be a dismal science.' But it is totally irresponsible to have a loud and vociferous opinion on economic subjects while remaining in this state of ignorance" (Rothbard).

Looking forward, the US should start by educating the public on the reality of tariffs, so that they can make informed voting decisions. At the very least, politicians should take a course on their true effects, since they are the ones writing them into law.

It is scary to institute these changes and open domestic markets to competition and potential temporary job losses. However, in the long run, the US will enjoy lower prices and higher levels of output, income, and consumption than could be achieved alone.

Inefficiencies will be eliminated and consumers will stop shouldering so much of the burden, which will allow our nation to focus more on progressive technologies and less on old-fashioned policies.

Works Cited

Beattie, Andrew. “What Is the Candle Maker's Petition?” *Investopedia*, Investopedia, 28 Aug. 2020, https://www.investopedia.com/ask/answers/08/candle-makers-petition.asp.

Carbaugh, Robert. *International Economics (17th Edition)*. Cengage Learning US, 2018, https://online.vitalsource.com/reader/books/9781337671224/pageid/44.

Davis, Ben. “Home.” *Mvorganizing.org*, 1 May 2021, https://www.mvorganizing.org/does-history-really-repeat-itself/.

Hooper, Charles L., et al. “Henry George's Protection or Free Trade: A Critical Review.” *Econlib*, 6 Sept. 2021, https://www.econlib.org/library/Columns/y2017/Hooperprotection.html.

Kenton, Will. “Mercantilism.” *Investopedia*, Investopedia, 27 Sept. 2021, https://www.investopedia.com/terms/m/mercantilism.asp.

Lincicome , Scott, and Inu Manak. *Cato.org*, Cato Institute, 9 Mar. 2021, https://www.cato.org/policy-analysis/protectionism-or-national-security-use-abuse-section-232.

Moran, Tyler. “Tariffs Hit Poor Americans Hardest.” PIIE, PIIE, 31 Aug. 2018, https://www.piie.com/blogs/trade-investment-policy-watch/tariffs-hit-poor-americans-hardest.

“Quotation of the Day: Murray Rothbard on ‘Economic ... - Aei.” *AEIdeas*, American Enterprise Institute, https://www.aei.org/carpe-diem/quotation-of-the-day-murray-rothbard-on-economic-ignorance/.

“The Senate Passes the Smoot-Hawley Tariff.” *U.S. Senate: The Senate Passes the Smoot-Hawley Tariff*, 2 Jan. 2020, https://www.senate.gov/artandhistory/history/minute/Senate_Passes_Smoot_Hawley_Tariff.htm.

“Smoot-Hawley Tariff Act.” *Encyclopædia Britannica*, Encyclopædia Britannica, Inc., https://www.britannica.com/topic/Smoot-Hawley-Tariff-Act.

Stephen Rose , et al. “Who's Really Paying for the Wall?” *Hinrich Foundation*, 2 Feb. 2017, https://www.hinrichfoundation.com/research/tradevistas/protectionism/mexican-wall-tariffs/.

“Walter Block Quote.” *A*, https://www.azquotes.com/quote/523552?ref=tariffs.