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Trump is wrong: Protectionism leads to misery, not prosperity

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Donald Trump tore up the broad consensus on international free trade with a miserable, protectionist inaugural speech on Friday. So explicit was his outlook that those of us who had become complacent about his economic impact – the “how bad can he be?” crowd – have had to sit up and reassess.

In a pugnacious passage, he claimed: “Every decision on trade... will be made to benefit American workers and American families. We must protect our borders from the ravages of other countries making our products, stealing our companies, and destroying our jobs. Protection will lead to great prosperity and strength.”

Basing every decision on trade or any other economic policy on whether it will benefit the body of American workers and families is a good metric for success, in theory. It would be refreshing if more politicians took setting the conditions for enhanced prosperity of the populace as a serious responsibility.

But there is a robust body of evidence that free trade does benefit ordinary families: directly, by providing wider access to, and cheaper, products; and indirectly by allowing specialisation of production to enhance productivity. Recent analysis by Jason Furman and others has shown that the US’s current protectionism through its body of tariffs is highly regressive, for example, since low income consumers spend more on food and clothing, which tend to be most highly protected.

Sadly, removing tariffs is not what Trump has in mind. When he says “American workers and American families”, he actually means workers and families of workers in industries “under threat” from foreign competition. For Trump, workers and families are US producers, not US consumers. Exports – the production of goods by Americans sold abroad – are regarded as positives, and imports – buying products produced overseas – negatives. The logical end point of his theory is that buying “foreign” hurts the US economy. Hence his “two simple rules: buy American and hire American”. Protection from imports will enrich America, in Trump’s view.

To be sure, openness to international trade increases the dynamism of economies and can hasten changes to a country’s industrial structure. There’s no doubt that certain groups can be affected by this – just ask the steel workers of Port Talbot. But protectionism to insulate workers and industries from economic change has costs, and these tend to be greater than any gains for the protected industries.

Let's take two examples: tyres and steel. In 2009, President Obama imposed tariffs on tyres in response to huge Chinese production. A Peterson Institute for International Economics study reckons this potentially saved 1,200 jobs. Yet the cost to US consumers was \$1.1bn due to higher tyre prices – making the cost per job saved around \$900,000. When one also considers the reduction of consumer spending power to buy other goods and services as a result of this, it seems almost certain on net that the protection destroyed jobs.

This is the great folly of protectionism. The issue of free trade is often portrayed as producers versus consumers. But it's actually *certain* producers versus consumers, as other producers bear the costs too – both because protections raise the cost of inputs and because consumers and affected producers have less remaining income to spend.

Bruce Blonigen's work on steel industry protection across the world also shows this clearly. Examining across countries, he finds that an increase in the price of steel due to protectionism is associated with significant increased costs for downstream industries. Machinery manufacturers and those who produce fabricated metals tend to see their export performance worsen substantially, and manufacturing in general sees declines too.

This all makes a mockery of Trump's idea that "protection will lead to great prosperity and strength". Economies are dynamic, complex systems. They are most strong and productive over time when they are free to adapt to new realities, circumstances and changing patterns of supply and demand. Was UK mining truly protected by overt government decisions to buy domestic coal in the late 1970s or early 1980s? Or was that protection merely insulating the industry from the competition of cheap natural gas, meaning that when the protection was withdrawn, the industry collapsed?

What we need to improve prosperity in the long term is not policies that protect certain industries at certain points in time, but institutions that allow an economy to become "anti-fragile" – a term coined by mathematician Nassim Nicholas Taleb to explain how something actually strengthens under risk, change and uncertainty.

If Trump goes down the protectionist route, he'll be hurting American consumers and the growth potential of the US economy. Yet even in the UK, many pundits and commentators who dismissed Trump's economic nationalism still embrace the EU's customs union, which imposes tariffs and quotas on non-EU goods. Exactly the same logic applies, even if it is at EU-level.

Both the UK and US will see big debates on foreign trade over the next couple of years. It's vital the free traders win.

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