Steve Bannon's Flawed History of 1800s Protectionism

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In today's Wall Street Journal, Dartmouth College economist Douglas Irwin has authored a lethal takedown of Steve Bannon's flawed theory that protectionism fueled America's economic rise in the 19th century. Bannon makes the double mistake of linking protectionism to "control of our borders," when in fact that era included historic levels of open immigration to the United States.

In my 2009 Cato book, *Mad about Trade,* I responded to similar arguments put forward by Pat Buchanan, who was a more articulate and refined version of Bannon but just as misguided. As I note at the end of the passage below, it's ironic that today's economic nationalists pine for an era of mass immigration and chronic trade deficits.

The high-tariff fable exposed

The biggest hole in the high-tariff fable is the fact that it was not the protected industries that led America's economic surge in the late 19th century. According to Douglas Irwin of Dartmouth College, the sectors with the fastest productivity growth were services such as transportation, distribution, utilities, and communications as well as construction. Productivity growth in those non-traded sectors was much more rapid after the Civil War than in manufacturing or agriculture. In contrast, protection of textiles, silk, and woolens did nothing to boost the overall output or competitiveness of the U.S. economy. It was not protected steel mills and textile factories that spearheaded America's emergence as a global economic power back then, but the railroads, the telegraph, the residential building trade, and electrical production and distribution.

While high tariffs on manufactured goods did nothing to promote America's overall growth, they did impose real costs and distortions on the U.S. economy. Tariffs on capital goods—machinery used to produce other goods—reached 40% by 1890, forcing American companies to pay artificially high prices for British machine tools, steam engines, steel rails, and precision instruments, reducing investment from what it would have been under free trade. Lower investment in capital goods retarded the growth of knowledge and productivity among American manufacturers. Another economic historian, the University of California-Berkeley's Brad DeLong, writes that the lesson from that period in American history is that "A high tariff economy is a lower-investment economy, a lower capital stock economy, and a lower wage economy."

High tariffs further aggravated the problem of industrial concentration and even monopolies. By shielding domestic producers from foreign competition, the tariff wall allowed them to exercise monopoly-pricing power against consumers. In the late 19th century, about the time of the Sherman Trust Act, a current saying was that “The tariff is the mother of the trust.” Those who denounce the trusts and the concentration of wealth at the time should aim at least some of the blame at high tariffs.

America’s industrial expansion in that era is less impressive in hindsight than the advocates of protection portray. What drove the expansion of U.S. manufacturing was not any great leap in competitiveness but a massive influx of capital and labor. In the language of economists, our industrial growth was “extensive” rather than “intensive.” We produced more because inputs of labor and capital grew, not because labor and capital together became dramatically more productive. When we consider the combined productivity growth of capital and labor, or “total factor productivity,” America’s record in the late 19th century was about the same as Great Britain’s during the same period. “In the end, productivity growth in the ‘protectionist’ United States was roughly the same as that in the ‘free trade’ United Kingdom,” concluded Dartmouth’s Douglas Irwin.

What allowed the United States to pull ahead of Great Britain in total output was the huge increase in the stock of both capital and labor. The capital came from domestic savings but also from abroad in the form of foreign investment, much of it from Britain itself. The steady inflow of capital from abroad was the main reason why the US ran almost continuous trade deficits through the second half of the 19th century. Much of the expansion of labor came from the rest of Europe in the form of millions of immigrants, the “huddled masses” who arrived at Ellis Island from Scandinavia, Germany, Italy, Poland, Austro-Hungary, and Russia, as well as China. In the half century from 1865 through 1914, the United States more-or-less welcomed 26.4 million legal immigrants. As a share of the U.S. population, the immigration rate during that period was more than double the rate today.

Consider the irony: The same era that Pat Buchanan and other trade skeptics praise for its high tariffs was also an era of persistent trade deficits and mass immigration! And all the evidence shows that it was those trade deficits and the inflow of foreign capital they accommodated combined with large-scale immigration that did the most to transform America into an industrial giant, not self-damaging tariffs.

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