Donald Trump's Worst Idea: Trade Barriers

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The ghosts of Reed Smoot and Willis Hawley are haunting the **presidency of Donald J. Trump,** even before it begins. To avoid the risk of recession, an exorcism of sorts is urgently required. Sen. Smoot and Rep. Hawley co-sponsored America's infamous Smoot-Hawley Tariff Act of 1930, which hiked tariffs on imports to record levels. A global trade war resulted, as other countries responded in kind. U.S. foreign trade plunged by 40%, which helped drag the economy into the Great Depression. More than 1,000 economists sent a petition to then-President Herbert Hoover urging him, without success, to veto the act, correctly arguing that it would "injure the great majority of our citizens."

In homage to those 1,000 economists, *Barron's* petitions incoming President Trump to appreciate the case for free trade in the hope of averting a similar injury to the nation's great majority. In fact, Trump should take steps to make U.S. trade policy freer than it is now, after a noticeable backslide over the past 15 years. Distressing echoes of Hawley and Smoot were heard from candidate Trump, both during his campaign and since his election. Even before putting his feet up on the desk of the Oval Office, he has killed the Trans-Pacific Partnership ("a terrible deal"), which had been agreed to by 12 Pacific Rim countries, and he has condemned the 22-year-old North American Free Trade Agreement with Canada, the U.S., and Mexico, on the shaky argument that it's costing American jobs.

In even more Smoot-like fashion, Trump has urged draconian across-the-board tariffs of 35% and 45%, respectively, on imports from Mexico and China, America's largest sources of imports in dollar terms. Such tariffs, says Cato Institute trade expert Dan Ikenson, "would be devastating to the U.S. and global economies and would destroy the international trading system." The result would be a global recession and a bear market in stocks.

If President-elect Trump wants to tweak America's 14 trade agreements to make them more favorable to U.S. exporters, there can be no great objection, though he might be surprised to find that negotiators on the other side of the table have legitimate grounds for pushing in the opposite direction.

As Ikenson points out, any aggressive move by the White House to hike tariffs will get pushback from a Republican-dominated Congress that has traditionally supported trade liberalization. Even greater pushback would come from business interests whose global supply chains depend on keeping trade barriers in check. Unlike the days of Smoot-Hawley, when imports were mainly end-products sold to consumers, half of all U.S. imports today are intermediate products sold to businesses, says Ikenson. The cheap imports help make it profitable for these businesses to operate—and to provide jobs to American workers.

Similarly, U.S. service industries—including tourism, entertainment, and financial management—have a stake in the huge trade surplus the nation maintains in services. This critical mass of businesspeople who benefit directly from foreign trade will likely make their voices heard on Capitol Hill, if not at the White House.

In response to Trump's repudiation of the Trans-Pacific Partnership agreement, China is already forging a similar agreement with its trading partners in Asia. Other responses by trading partners could diminish U.S. trade, and harm the economy, in even more serious ways.

Our tariffs would not just have the intended effect of reducing our imports. If we import less, foreigners will have fewer dollars to buy our exports. "Countries cannot permanently buy from us unless they are permitted to sell to us," wrote those 1,000 economists to President Hoover, "and the more we restrict the importation of goods from them by means of ever higher tariffs, the more we reduce the possibility of our exporting to them."

Even more devastatingly, other countries might respond with tariffs of their own, unleashing a trade war that would truly bring a replay of Smoot-Hawley.

"IN EVERY COUNTRY," wrote Adam Smith in *The Wealth of Nations*, "it always is and must be the interest of the great body of the people to buy whatever they want of those who sell it cheapest. The proposition is so very manifest, that it seems ridiculous to take any pains to prove it." Smith went on to observe that this self-evident proposition could not "have been called in question, had not the interested sophistry of merchants and manufacturers confounded the common sense of mankind."

The evolution of U.S. trade has run according to Smithian script. America's trade in goods was in approximate balance from the 1950s through 1980, but started to move into deficit as cheap labor from abroad began to out-compete more costly domestic labor. The process accelerated with the advent of technology that made it far cheaper to ship goods across oceans and deliver them to ports, and by liberalizing trade agreements starting in the 1950s and 1960s under the General Agreement on Tariffs and Trade and later under the World Trade Organization, which supplanted GATT in 1995.

The process further accelerated in the 1990s with the end of the Cold War, making it possible to employ workers in former Communist countries of Eastern Europe and Asia; with the North American Free Trade Agreement of 1994; and with China's entry into the WTO in 2001. Since

2001, nearly 80% of the growth of America's trade deficit in goods can be attributed to the ballooning goods gap with China.

The result has been a bonanza of cheap goods for U.S. consumers and businesses. Meanwhile, the excess dollars earned by those who sell us more goods than they buy from us mainly come back as purchases of U.S. stocks and bonds, or as direct investment.

Globalization has also brought America a growing surplus in services trade. When candidate Trump quoted a "trade deficit" of "nearly $800 billion" in the "last year alone," he was focusing on the deficit in goods, not the overall tally for goods and services. Over the past four calendar quarters, the U.S. ran a merchandise trade deficit of $763 billion, in part offset by a surplus in services trade of $268 billion, bringing the total shortfall to about $500 billion.

Consider, too, that the overall trade deficit averaged 3.0% of gross domestic product over the current expansion, down from 5.1% during the expansion of 2002-07, when GDP gains were more rapid. Similarly, the goods deficit cited by our incoming president has declined to 4.2% of GDP during the current expansion from 5.6% during the expansion of 2002-07 (see chart). These are inconvenient truths for those who subscribe to the myth that trade deficits bring slow growth.

Protectionists seem to forget that, while many Americans are workers, all are consumers—and that the central purpose of any market economy is to serve consumers' needs. As a candidate, Trump declared that globalization has brought "nothing but poverty." But for the tens of millions of consumers who buy from Wal-Mart, which is a huge seller of cheap imports, globalization has brought nothing but enrichment, although most of Wal-Mart's customers are probably not aware of this. Wal-Mart's 1.5 million U.S. employees are also on the winning end.

While Adam Smith was correct that "the great body of the people" benefit from free trade, those who lose their jobs to foreign competition do not. These displaced workers deserve compassionate treatment, and if they end up in financial distress, aid can be offered. But if we singled them out for special treatment, we would be unfairly ignoring the more than 95% of job losers who get displaced as a result of domestic competition.

The highest estimate for jobs lost to foreign competition in merchandise trade puts it at four million over the 12 years from 2001 to 2013, or 333,000 per year. That sounds like a lot, but it's just 2.7% of the 12.5 million jobs lost each year in the private sector over the same 12-year period, according to the Business Employment Dynamics survey of the Bureau of Labor Statistics. (The number of new jobs created by the private sector over that same period averaged 12.8 million.)

Update these figures and you get similar results. Since 2013, job losses have diminished and job gains have increased. Over the three years through March 2016, jobs destroyed averaged 10.3 million per year and jobs created 12.7 million. Even assuming that annual jobs lost to foreign competition have increased to 400,000, that's still less than 4% of the 10.3 million annually destroyed.

CRITICS OFTEN COUNTER with the strange argument that jobs lost domestically have very different consequences from jobs lost to competition from abroad. In their version of the dynamic, if workers are displaced in one region of the country, they can always move to the

region where the businesses that took their jobs are providing more employment. They can't, however, move to China.

But many, if not most, jobs lost domestically are casualties of automation or of industries losing market share, which in itself can be a consequence of technology. Automation is the reason manufacturing's share of all employment fell from a peak of 32.5% in 1947 to 21.6% in 1979, well before significant inroads were made by cheap labor from abroad. Once-dominant bricks-and-mortar bookseller **Barnes & Noble** has had to decimate its workforce as its business has been lured away by the cheaper and more convenient services of **Amazon.com**. Bank tellers have been replaced by ATMs. And jobs in print journalism have been eliminated as a consequence of the massive transfer of advertising revenue to the Internet.

Protectionists often invoke U.S. history—citing, in particular, the high tariffs in the nation's past—as proof that such levies are needed for economic development. They are right on the facts about high tariffs in the U.S. of the 19th century, but wrong on every other count. In fact, this country is a good example of how free trade fuels economic growth.

Critics forget that America at that time was a vast and unparalleled free-trade zone, operating with virtually no restraint. Protectionists couldn't stop the textile industry in the South from supplanting that industry in the North, or the auto industry in Detroit from destroying the horse-and-buggy business. The creative destruction that free trade helped unleash spurred economic development. The tariffs, which special interests pushed through, were a drag that was more than offset by domestic free trade.

Indeed, the U.S. remains one of the world's largest free-trade zones, measured according to the dollar value of goods and services crossing state lines. Happily, the protectionists have not urged that New York stop trading with California, although they would impede trade with Canada and Mexico.

One source of domestic employment from trade comes from investment by foreigners in the U.S. A trade deficit with the rest of the world of $500 billion means that the equivalent of that sum must go somewhere. As noted above, most of the dollars come back as purchases of U.S. stocks and bonds or as direct investment. In 2015, new foreign direct investment in the U.S. alone exceeded $300 billion.

Early this month, The Wall Street Journal reported that President-elect Trump had proudly brokered a deal whereby the Japanese multinational **SoftBank Group** agreed to invest $50 billion in the U.S. and create 50,000 jobs. One wonders if Trump realized that this deal, in effect, left $50 billion unavailable to buy U.S. exports.

The Fraser Institute's economic freedom index reveals a clear relationship between openness to trade and economic prosperity. One of the institute's five main components of economic freedom is "freedom to trade internationally," which tracks a broad array of constraints that affect international trade. With the ratings measured on a scale of 0 to 10, a high rating means "low

tariffs, easy clearance and efficient administration of customs, a freely convertible currency, and few controls" on capital movement.

In the institute's annual publication, its researchers rank countries according to its summary economic freedom index for all five components of the index. The data are sorted into quartiles from highest to lowest, and then compared with various measures of economic growth and well-being.

At *Barron's* request, consulting economist Robert Lawson of Southern Methodist University did the same exercise, but ran the quartiles according to each country's rating on "freedom to trade." In each case, the freedom-to-trade rating was averaged over the period from 1990 to 2014, the most recent year for which data are available, to capture each country's policy over the past quarter-century.

If the protectionists are right, then the results should indicate that openness to trade correlates with "nothing but poverty," in Trump's words. The opposite happens to be true. The charts on this page reveal that countries with greater openness to trade have substantially higher per-capita incomes and more-rapid economic growth. The share of income earned by the poorest 10% of people in a given country is unrelated to openness to trade. And the income of the poorest 10% in lands with the greatest openness to trade is more than 11 times higher than in countries with the least openness.

WHERE DOES THE U.S. FIT IN? Its index of freedom to trade is in the top quartile over the period from 1990-2014, but only because of relatively high figures from 1990 through 2000. Since 2000, America's freedom-to-trade index has fallen, during both the Bush and Obama administrations.
In 2014, the U.S. scored 7.56 on a scale of 0 to 10. Among the 159 countries the Fraser Institute now tracks, the U.S. now ranks 60th with respect to freedom to trade, which means it has fallen to the second quartile among nations. Among its key trading partners, America is ahead of China (6.78), about comparable with Mexico (7.48) and Japan (7.67), and somewhat behind Canada (7.83).

And while it is way ahead of such countries as Argentina (3.44), Iran (2.97), India (5.56), Pakistan (5.81), Russia (5.84), and Venezuela (3.13), it lags behind Chile (8.35), Denmark (8.51), Finland (8.16), Ireland (8.73), New Zealand (8.65), Sweden (8.32), the United Kingdom (8.28), and more than 50 other nations.

As international trade attorney Scott Lincicome notes, the U.S. levies hefty tariffs on highly lobbied products, including tuna (35%), light trucks (25%), wool sweaters (16%), various dairy products (20%), and peanuts (a whopping 131.8%). This country also maintains restrictive quotas on products including sugar, cheese, and cotton.

The U.S. has 14 liberalizing trade agreements with 20 countries and is a longtime member of the World Trade Organization. But it has gotten many of its high-lobbied products exempted from those agreements. If President-elect Trump wants to renegotiate America's trade agreements, giving up those exemptions could be a good place to start.