

Tariff Follies

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The hot air blowing around tariffs and other trade barriers doesn't match the reality.

When national friendships turn sour, trade disputes – especially tariffs – are never far away.

They're the perfect foil. They look like fees paid for by foreigners. Imposing tariffs on China last year, President Trump took advantage of this exact argument. "You're not paying for those tariffs," he stated, "China's paying for those tariffs." But they're actually paid by anyone who buys an item subject to a tariff, so that means American importers. And the bill is growing. According to the Cato Institute, tariff revenue collected in the U.S. under Trump grew from \$33 billion in 2017 to \$71 billion in 2019.

The bulk of that either came out of consumers' pockets or out of the profit margins of various middle men. Maybe a few manufacturers cut prices to keep their products competitive, but there's no hard evidence that this happened with China. In fact, the Federal Reserve Bank of New York has calculated that these tariffs cost each U.S. household \$831 annually.

It's surprising that, until 1913, tariffs were the main source of revenue for the U.S. federal government, at times supplying as much as 95 percent of its budget – until the arrival of the universally-loved federal income tax. For comparison, the \$71 billion collected in 2019 from U.S. tariffs was a mere two percent of federal revenue. That's nice to have, but please don't entertain any illusions about skipping April 15!

Despite their prominence in discussions about trade, tariffs are relatively low. The U.S., E.U. and China charge an average non-discriminatory ("most favored nation") tariff of, respectively, 3.34 percent, 5.14 percent and 7.56 percent. Even the worst offenders' tariffs are lower than you might think, e.g., India sits at 17.57 percent. The Bahamas stands out as the global #1 at 32.45 percent.

Historically, tariffs have been much higher. The current low rates are thanks to years of free trade negotiation. "Despite this noise, there is a clear pattern...that tariff rates are falling over time," reported the Mercatus Group in 2019. Even U.S. and Chinese tariffs used to be significantly higher than they are now.

Feeling Threatened

All of this is great news for anyone who likes trade and is open for business. Why, then, does it feel like the global economy has never been more threatened, that the doors are closing all at once?

Maybe it's pandemic-induced uncertainty. The hot new buzzwords are "localization" and "reshoring." Moody's Deborah Tan suggested that risk mitigation along those lines would lead to

reduced dependence on China and might generally have a negative effect on Asia-based manufacturing's near-term outlook. This is especially true in sectors deemed strategic, like pharmaceuticals, where recent bottlenecks led to surging nationalist sentiment and the wish to control production from A to Z.

Such arguments make tariffs look not only inevitable, but smart. With tariffs, the logic goes, local producers are protected and can flourish. A financial incentive is created to move manufacturing back home. This way, the profit motive doesn't interfere with everybody's legitimate desire to be safe in a time of peril. Difficult, treacherous, vulnerable supply chains in exotic, far-away places can be avoided. And even better, tariffs mean the government gets "free" money to pay for services you want and love.

Even if tariff cooperation totally broke down and each country began to fend for itself, a "worst case" scenario projected by the World Trade Organization estimates a global fall in GDP of just two percent and in trade of 17 percent. And the "worst case" scenario is seeming more probable. Ben Simpfendorfer of Silk Road Associates, referencing U.S.-China trade tensions, stated, "We are moving to a new model entirely shaped by competing forces."

The Big Picture

But tariffs are not the only, or even the biggest threat, though they regularly dominate the news. The European Commission's 2019 Trade and Investment Barriers Report zeroed in on so-called "barriers to trade," of which 438 existed per the E.U.'s Market Access Database in 58 countries.

Only 17 percent (!) of these were tariffs or equivalents. The rest were a mix of administrative procedures, technical barriers, sanitary measures and other attempts to choke off undesired imports with red tape. These other barriers represent "restrictions related to services, investments, government procurement, intellectual property rights or unjustified technical barriers to trade concerning trade in goods."

Despite representing less than 20 percent of overall barriers to free trade, tariffs make great fodder for the evening news due to how simply they can be politicized and how blatantly nationalistic they appear.

A breakdown of which countries are responsible for said trade barriers is a veritable "who's who" of big, powerful countries who, presumably, can afford to throw their weight around. China was the worst offender with 38 non-tariff barriers. Russia followed with 31. Then came Indonesia with 25 and the U.S. with 24. India and Turkey both had 23. The grim prognosis: "This continuing and significant increase signals that protectionism has structurally become part of the very fabric of international trade relations. This new reality can have a profound effect on our trade flows."

The cultural shift against trade has been building for some time now, from Ross Perot's quixotic 1992 presidential run and the "giant sucking sound" to the grassroots European anti-globalization movement of 2009 and onward, which vituperated against "casino capitalism" and saw crowds in France, Greece, Germany, Britain and Iceland and attacks on the World Economic Forum in Switzerland. It's clear that this high-stakes, high-level game of chess is driven by national economic interests.

And let's not forget the collective European nuclear-sized meltdown over the 2013 Transatlantic Trade and Investment Partnership (TTIP), which was supposed to create the world's biggest free trade zone between the E.U. and U.S. When push came to shove, chlorinated chicken horror stories and "people over profits" won out. Cecilia Malmstrom, then E.U. Trade Commissioner, reacted to some of the most outlandish hysterics: "The assertion that we'll be flooded with genetically modified food is simply wrong. Our democracy of course won't be undermined as some seem to believe."

Imperfect as it is, the current system – unsurprisingly – is not winning any hearts or minds. But when the point has been reached that something as anodyne as free trade can be accused of destroying democracy, it seems like something serious has fundamentally gone wrong.

Hot Air

If popular movements, the European Commission, economic analyses and President Trump all agree that we should be – and are – entering into a new era of trade policy, where does that leave shipping?

To start with, as the numbers already cited show, the hot air blowing around tariffs and trade and the intensity of the arguments they engender do not nearly match the reality. Even in the worst case scenario, a 17 percent drop in global trade – and, presumably, gradually increasing volumes thereafter – are what we might expect.

That would be a problem, but it would not be fatal. The astonishing growth in global trade volume has continued unabated with exports as a share of GDP on a global basis having consistently exceeded the record threshold of 25 percent since 2014. Even a one-off two percent dip in GDP would only represent a one- or two-year setback. The cyclical, long-term trends of more trade, more volume and more growth would not stop over tariffs.

Overall, TEU growth is and remains on a positive trajectory – e.g., as of July 2020, Asia-Europe trades finally moved into positive year-over-year growth territory, blowing past the lockdown-induced malaise. The global financial crisis in 2008 also witnessed a momentary dip in volume from roughly 500 million TEUs to 470 million TEUs of global throughput. By 2019 global throughput had reached 802 million TEUs, which, incidentally, amounted to a 2.3 percent increase over 2018.

These kinds of developments, based on orderbooks and investments that take years to bring to fruition, spell doom for anti-globalization critics. They also present a significant political stumbling block for anyone seeking to deprioritize global trade.

Theatrics

What's left is what we have seen: posturing, theatrics and fighting on the fringes. Every barely perceptible nano-movement of the proverbial needle is celebrated as a huge anti-globalization victory. That will only resonate with people who do not grasp the big picture. – *MarEx*