Trump's negative protection racket

By Paul Krugman
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What economic thinking went into the Trump tariffs announced last week? None at all. In fact, the economists ("economists"?) who currently have his ear seem to regard their job as being to confirm the wisdom of whatever he decides to do. Peter Navarro:

> My function, really, as an economist is to try to provide the underlying analytics that confirm his intuition. And his intuition is always right in these matters.

Translation: Navarro sees his role as that of a propagandist, not a source of independent advice.

But the rest of us don't have to accept that Dear Leader is always right. And in fact, these tariffs are weirdly poorly considered *even if all you want to do is create manufacturing jobs*, leaving aside all the other ramifications.

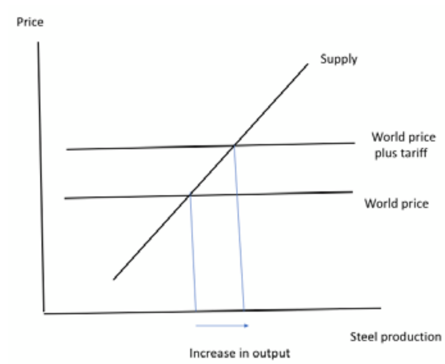
Why? Because steel and aluminum aren't final goods – nobody directly consumes steel. Instead, they're intermediate goods, basically used as inputs to other U.S. manufacturing sectors. And while tariffs that raise primary metal prices may increase production of those metals, they make the rest of U.S. manufacturing *less* competitive.

Trade economists used to talk about this kind of thing a lot. Back when most developing countries were trying to promote manufacturing with tariffs and import quotas, we used to talk about *effective protection*, which depended on the whole structure of tariffs. Sometimes effective rates of protection were very high: if you imposed, say, a modest tariff on cars but none on imported auto parts, the effective rate of protection for auto assembly could easily be in the hundreds of percent. Sometimes, however, rates were negative: if you put a tariff on parts but not on cars, you were actually discouraging auto assembly.

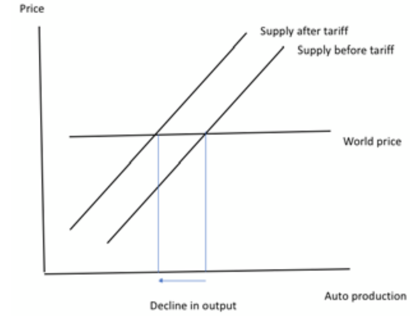
Clearly, we can apply this kind of analysis to the Trump tariffs. In fact, there are people out there trying to put numbers on it, although I wouldn't put too much weight on them, for reasons that will be clear in a minute.

What I want to do, mainly to scratch my own analytical itch, is briefly sketch out how this story should work in this case. For the purposes of this post, I'm going to treat the US as a small open economy facing given world prices; that's not quite right, but I don't think it would change the basic point to make it more realistic.

So, let's suppose we put a tariff on steel imports. What this does is raise the price steel producers can charge, and it should lead to a rise in steel output:



But steel is used by other manufacturers, say producers of autos, and their costs rise when steel prices go up, shifting their supply curve back, and reducing their output:



So what is the net effect on manufacturing output and manufacturing jobs? It’s not obvious, because it all depends on the details. How sensitive are steel output and employment to prices? How sensitive are output and employment in other sectors to costs? People are trying to estimate all this, but I wouldn’t put too much faith in those estimates, simply because these are hard questions to answer. And there are further complications once, for example, you take into account possible effects on the exchange rate.

But still, the key point is that even while embracing protectionism, Trump is imposing *negative* protection on a lot of manufacturing. That’s hardly the story he wants people to hear – and he’s almost surely doing it by accident, out of sheer ignorance (because his “advisers” aren’t in the business of, you know, giving advice.)

And this is how we risk a trade war?