The real cost of Trump's tariffs

By Jeffrey Frankel

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Whereas winners tend to outnumber losers when trade is liberalized, raising tariffs normally has the opposite result. US President Donald Trump appears to have engineered a spectacular example of this: his trade war with China has hurt almost every segment of the US economy, and created very few winners.

Earlier this month, US President Donald Trump suddenly revealed that a trade agreement between the United States and China was not imminent after all. On the contrary, on May 10, the Trump administration raised its previous 10% tariff on $200 billion worth of Chinese goods to 25%, and threatened to apply the same rate to the remaining $300 billion or so of US imports from China by late June. China then retaliated with reciprocal tariffs on $60 billion worth of US exports, effective June 1. Surprised stock markets fell in response, with the S&P 500 down 4% over the first week of the renewed trade war.

US trade policy is now a hot mess of conflicting goals. Given the current impasse in talks with China, and Trump's general unpredictability, the inconsistencies of US trade policy – and their costs – are unlikely to go away soon.

For starters, US officials and some prominent economists defend the high US tariffs as a regrettable but temporary expedient, and a necessary means to a strategic end. On this view, the tariffs are a weapon that will enable Trump, the consummate dealmaker, to force concessions from China and America's other trading partners.

Yet Trump looks and talks like someone who would be perfectly satisfied if the tariffs became permanent. He continues to insist that China is paying the cost of the tariffs, sending money to the US Treasury. Moreover, he seems unfazed by the possible long-term effects of a protracted trade war: a decoupling of the Chinese and American economies, and a loss of gains from trade, including a dismantling of the supply chains on which so much industry in both countries depends.

At the same time, the Trump administration is demanding that China make it easier for American companies to set up operations in the country – in particular, by ensuring that US firms aren't required to hand over technology or other intellectual property to local partners. But this seems inconsistent with Trump's goal of increasing US net exports to China, which would presumably involve American firms producing at home rather than in China.

The incoherence of Trump's trade policies is even more worrying on closer inspection. If higher tariffs remain indefinitely – as now appears possible – the US and the global economy will be worse off.

Trump's gleeful belief that China is helping to fund the US government via the tariffs is outlandish. A tariff is a tax, and it is US consumers and firms, not China, who are paying it. True, Chinese exporters might in theory have had to lower their prices if US tariffs had led to a sufficiently large drop in demand for their products. But two new studies by eminent economists using 2018 data find that Chinese exporters have not lowered their prices and that, as a result, the full extent of the price increase has been passed through to US households.

According to one estimate, if Trump goes ahead with his threat to extend the 25% tariff to all imports from China, the cost for a typical US household will be $300-$800 per year; another puts the additional costs as high as $2,200 per year. Moreover, this does not count the cost to

US firms, workers, and farmers from lost exports – the result of Chinese retaliation and other effects, including appreciation of the dollar against the renminbi.

An extended tariff war would also result in a loss of gains from US-China trade. Economists have long said that the public can't be expected to understand the principle of gains from trade without having been taught British economist David Ricardo's principle of comparative advantage. This idea – which states that trade between two countries can be mutually beneficial even when one country can produce everything more cheaply than the other – was famously described by US economist Paul Samuelson as being both universally true and yet not obvious.

But in fact, one does not need a full grasp of the principle of comparative advantage to understand the basic idea of mutual gains from trade. If both the buyer and the seller voluntarily agree to the exchange, then they both gain. This assumes that they are each good judges of what they want – or at least better than the government is. This assumption is usually correct, with some exceptions (such as users' opioid purchases).To say that both countries gain overall from trade is not to claim that every citizen of each country benefits. Changes in trade or tariffs give rise to both winners and losers within each country. But whereas winners tend to outnumber losers when trade is liberalized, raising tariffs normally has the opposite result.

Trump appears to have engineered a spectacular example of this: his trade war with China has hurt almost every segment of the US economy, and created very few winners. The losers include not only consumers, but also firms and the workers they employ, from farmers losing their export markets to manufacturers forced to pay higher input costs. Even the US auto industry, which did not ask for Trump's "protection," is worse off overall because it has to pay more for imported steel and auto parts.

As a result, Trump has come close to accomplishing something seemingly impossible: tariffs that benefit almost no one. Protectionism is usually explained as the result of special interests wielding disproportionate power. Trump's tariffs against Chinese goods don't fit this theory. And a theory that does explain them may not exist.

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