

EconoFact Chats: What Populists Don't Understand About Tariffs (but economists do)
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I'm Michael Klein, executive editor of EconoFact, a nonpartisan, web-based publication of the Fletcher School at Tufts University. At EconoFact, we bring key facts and incisive analysis to the national debate on economic and social policies, publishing work from leading economists across the country. You can learn more about us and see our work at www.econofact.org.

Michael Klein

A signature policy proposal that former President Trump has made in his campaign is large, across the board tariffs, claiming that the United States has been ripped off for years in its trade with other countries. In the vice-presidential debate, JD Vance championed this policy and the trade policy during Trump's administration, decrying the view of experts who, according to him, promoted shipping U.S. manufacturing abroad for the promise of cheaper goods, which he said did not materialize. Expert opinion has also been challenged by Oren Cass, chief economist at the conservative think tank American Compass, in an article he recently published in The Atlantic. The article is titled, "Trump's Most Misunderstood Policy Proposals - Economists aren't Telling the Whole Truth about Tariffs." Aren't they? Two prominent economists, Maurice Obstfeld and Kimberly Clausing, wrote a response to Cass's article, but The Atlantic declined to publish it. So, I'm happy to give Maury a chance to air the challenges that he and Kim have made to this article, and the idea that broad tariffs benefit the United States. Maury is a senior fellow at the Peterson Institute for International Economics, which posted the article he co-authored with Kim on their website. He is Professor of Economics Emeritus at Berkeley. He served as a member of President Obama's Council of Economic Advisers. And from 2015 to 2018, he was the Chief Economist at the International Monetary Fund. Maury, welcome back to EconoFact Chats.

Maurice Obstfeld

Thanks Michael, it's great to be here again.

Michael Klein

Well, it's wonderful to have you on once more. Maury, the article you wrote with Kim is titled, "What Populists Don't Understand About Tariffs, (but economists do)." We'll discuss what economists do in fact know about tariffs from decades of empirical analysis, based on time tested theoretical frameworks. But first Maury, can you review what candidate Trump has proposed for a tariff policy, were he elected?

Maurice Obstfeld

His basic proposals are for 10, sometimes 20 percent tariff on all goods imports, with the exception of China, which would draw tariffs at 60 percent. Moreover, there's a range of threats to use tariffs for diverse goals, including in the foreign policy sphere. He's threatened countries that "leap the dollar" with tariffs. He has suggested that instead of the US using financial sanctions against adversaries such as those it deployed against Russia and Iran, it use tariffs

instead. So, there's a broad agenda to make tariffs a prime policy tool, but also a ever-present policy tool.

Michael Klein

And this level of the use of tariffs is unprecedented, isn't it?

Maurice Obstfeld

We've certainly had broad tariffs in the past in the United States. These tariffs were used primarily for revenue purposes. In fact, they led to a lot of discontent. I mean, they reached their height during the Gilded Age when we had vast inequality in the United States. And it was perceived that tariffs are a regressive tax both on consumers and on businesses. And as a result of this, we actually amended the constitution to allow a graduated income tax. And at that point, tariffs were dropped substantially. Now they came back during the Depression. But even if you look at the infamous Smoot Hawley tariff of 1930, it covered far lower percentage of our imports, and was lower [in] magnitude than what Trump is proposing now.

Michael Klein

So, it's been almost a century since the Smoot Hawley tariffs and well more than a century during the tariffs of the Gilded Age. And the United States has been trying to lead the world in reducing tariffs, especially in the postwar period, correct?

Maurice Obstfeld

Yes.

Michael Klein

In his article, Cass cites Paul Samuelson, the great 20th century economist, who was in favor of free trade. What do you think Samuelson would make of Cass' arguments, in particular his argument about the role of tariffs in resolving trade deficits?

Maurice Obstfeld

I certainly don't want to speak for Samuelson, although I knew Paul Samuelson. But I think if you pressed him, he would say that countries have sometimes imposed tariffs in an attempt to reduce the trade deficit because tariffs definitely reduce imports. But I think he would not insist that that prediction extends to a prediction that tariffs actually succeed in reducing the trade deficit because they also have broader effects elsewhere in the economy. And in fact, on exports, Samuelson was well acquainted with the research showing that.

Michael Klein

Cass uses an analogy in his article. He couches his argument for tariffs as an example of using taxes to redress a market failure, as is the case with carbon taxes, since the effects of polluting are what economists call an externality, something that's not reflected in the price of gasoline or coal. Is this a valid comparison?

Maurice Obstfeld

I think it's a very misleading comparison. In the case of carbon taxes, the problem is that individuals and businesses don't take into account the damages from their carbon emissions. And

the appropriate carbon tax simply adds to market prices, the social costs of those emissions. And so it's a direct correction of the distortion of the externality, if you will. What Cass is talking about is the much broader disruption that can occur when international trade causes factories to close, when it leads to some workers losing their jobs, and indeed when it leads to communities collapsing because the jobs leave. Now, unfortunately, this is not an imaginary scenario. It certainly has happened in parts of the country. But to say that tariffs directly address the distortions involved in those sorts of events is quite misleading for policy recommendations. For example, if you really think that there is a distortion because it is harder for unemployed workers to find new jobs once the local factory closes, the appropriate intervention would be job training programs, perhaps, which research has shown actually are somewhat more effective than economists thought until recently. So you can sort of pick apart all the ills associated with the unfortunate occurrences that Cass highlights. And tariffs are not the way to go about correcting them. They don't necessarily correct them. Just to give you one counter example, if a plant closes down in Ohio, and we think that protective tariffs will lead to more manufacturing jobs in the U.S. as a whole, there's no guarantee they come back in the specific part of Ohio which is distressed. So, I find it sort of a sleight of hand when he uses the term externality, and I don't think his examples hold water.

Michael Klein

It's also problematic, isn't it, that the jobs from Ohio might move to Alabama, or they might disappear because of automation, and tariffs wouldn't address either of those problems.

Maurice Obstfeld

No, it's true. There's a lot of churn within manufacturing. A huge amount of gross inflows and outflows. The inflows don't necessarily occur where the outflows of manufacturing jobs occurred, and tariffs can't possibly address this because all this is happening within U.S. borders.

Michael Klein

So you and Kim write at the beginning of your article that an assessment of tariffs as a policy tool must answer three questions. Let's go briefly through them. First, how costly are tariffs?

Maurice Obstfeld

Very.

Michael Klein

Okay. Second, would tariffs deliver a manufacturing renaissance leading to higher middle-class wages and more stable families and communities?

Maurice Obstfeld

Simply put, the answer is no.

Michael Klein

Okay. Third, would other policy tools be more effective than tariffs?

Maurice Obstfeld

Absolutely. Yes.

Michael Klein

Okay. Well, rather than be done with the interview at this point, let's go into these in a little bit more detail. Why are tariffs costly?

Maurice Obstfeld

Well, what tariffs essentially do is they, and this is the insight that comes from the classical economists from the area of comparative advantage, they induce us to produce things that we could obtain abroad more cheaply instead of focusing on the activities that we ourselves can carry out most efficiently and exporting the resulting goods for imports.

Michael Klein

Kamala Harris has said that tariffs are like a national sales tax. Is that an apt comparison?

Maurice Obstfeld

It may be political best practice, but there are a couple of respects in which tariffs are actually far worse than the sales tax. Like a sales tax, they raise prices of goods directly, namely import goods. But any goods produced domestically which compete with imports will also undergo comparable price rises because the producers suddenly are operating behind a wall of tariff protection. That's why it's called protection. And they can raise their prices without fear of losing customers because the ability of customers to go for cheaper imports has been compromised by the tariffs. Where there's a big departure from the sales tax is that those goods whose prices rise which are not imports, but which compete with imports, the government doesn't collect any revenue on those, unlike in the case of a sales tax. So, to collect the same amount of revenue, you need a much higher tower. In other words, you need a higher sales tax. And we know the tariffs are very, very regressive. And one of the proposals that Trump has thrown off is the idea to replace the income tax with tariff revenue. And this would amount to going immediately back to the world before the 16th Amendment, that gilded age world where consumers and businesses suffered because of high tariffs. And where the incomes of the very wealthy, you know, the robber barons, the people who operated the trusts were untaxed.

Michael Klein

In fact, the government is much bigger now than it was in the days of McKinley. And it's hard to imagine that enough revenue could even be raised by tariffs to cover the government's needs. Isn't that correct?

Maurice Obstfeld

Oh, yeah, it is. It's totally correct. And my Peterson colleagues, Doug Irwin and Alan Wolf, actually put out a blog on Friday where they point out that once McKinley became president, he was a very pro-tariff guy when he was in Congress, but once he became president, he actually talked about reciprocal tariff reductions and the importance of avoiding trade wars.

Michael Klein

So, Cass also claims that the inflationary effects of Trump's 2018 tariffs were not apparent in the data. And is that true? And more to the point of the current debate, even if it were true, can we extrapolate that result to the much broader tariffs that he's now proposing?

Maurice Obstfeld

Well, I'm not sure what data he's looking at. You know, overall inflation did rise in 2018, which is why the Fed was raising interest rates. And why President Trump was tweeting that Jay Powell was a worse enemy of the U.S. than Xi Jinping. So, there was inflationary pressure. You know, how much was due to tariffs is unclear. But fortunately, we have much more detailed studies of particularly good which were tariffed. And the studies at the product level indicate that the prices that American consumers had to pay rose pretty much by the full amount of the tariff. So, among these papers, there's one by Mary Amiti and co-authors at the New York Fed. This was in the Journal of Economic Perspectives. There's one by Penny Goldberg in the QJE and co-authors. There's a nice paper on washing machine tariffs, which were really the first set of tariffs that Trump implemented in 2018 by Ali Hortacsu and co-authors in the AER. And they find that actually, not only did the washing machine prices rise by the full amount of the tariff, but sellers of dryers raised the prices of those too, even though they weren't tariffed. So, if you look at these more detailed studies of specific products, which can control for all the other things happening in the economy, you do find very strong evidence that tariffs raised prices. And then there's the point you raised, you know, what Trump levied tariffs on in 2018-2019 was probably about an eighth of the amount of trade that would be subject to tariffs now. So that in itself would give you a commensurately higher inflationary effect.

Michale Klein

Maury you alluded to when tariffs are put on imports, there's an effect on exports. And that I guess also speaks to whether or not tariffs could help bring back manufacturing, which had been seen as a way for people without a college education to make good middle-class wages. So your point is that tariffs won't spur manufacturing and help revive the middle class, right?

Maurice Obstfeld

I think the goal of reviving the middle class is a very laudable one. But much as in the discussion of the carbon tax, we need much more targeted policies to do that, to create the opportunities for workers more broadly to enter the middle class. And going via the route of tariffs is not only inefficient in the sense that the collateral damage is too great, but it's quite ineffective. There's very little evidence, that certainly in the recent episodes, that tariffs can restore manufacturing. You know, manufacturing has declined across a broad range of countries. In fact, all countries eventually see declining manufacturing. And this is true of deficit countries and surplus countries. It's even true that in China, manufacturing as a percentage of total employment has been declining since around 2013 or 2014.

So, you know, the idea that we're going to alone reverse this international trend I think is somewhat fanciful. And then again, you know, if you look at product level studies of the Trump tariffs of 2018 and 2019, you find that on net they cost manufacturing jobs. And they cost manufacturing jobs in part because – this is a very important point, they raise costs of intermediate products that firms import in order so that they can produce for the domestic market and for exports. And also, manufacturers in the US, manufacturing exporters suffered tariff retaliation from other countries, which also is costly in terms of jobs. And Trump seems to dismiss tariff retaliation. But if you go back to the literature on the Smoot Hawley tariff, and the Smoot Hawley tariff in itself was somewhat costly for the US. But more recent research by

economic historians shows that what really hurt was the trade war that the Smoot Hawley tariff helped ignite. And that's what led really to collapse during the Great Depression.

Michael Klein

Cass also cites the experience of Asian nations as well as America in the late 19th and early 20th century as examples of how tariffs helped develop manufacturing. Are these comparisons even valid for America today?

Maurice Obstfeld

All of these examples, including that of the US prior to World War I and even after World War I, these were examples of economies where significant fractions of the labor force were employed in agriculture. And in fact, agricultural productivity was very high. This drove workers into manufacturing. It is true that a number of these countries levied tariffs, but it's unclear how effective these tariffs were, how helpful they were in actually spurring this movement of workers into manufacturing. The US today is not heavily agrarian. There isn't a large pool of farm workers who can move into manufacturing. And even in these Asian countries where that was true, they pursued very vigorous export promotion policies. And in many cases, there were economic advisors pushing them to lower tariffs as well as promote exports. The reason they didn't was that there were strong vested interests opposing that. Not so much that governments thought, oh, these tariffs are really great. Instead, governments were basically protecting vested interests at the expense of consumers. One way to see this dilemma for the US, were it to follow Cass' suggestions is the point that I referred to before, Paul Samuelson, was well familiar with, that essentially when you tax imports, you tax exports. And this makes it very hard to really move the trade balance by protectionist policies. If we're going to produce more goods for ourselves that we previously imported, the labor to produce those has to come from somewhere. And if we don't have a vast pool of unemployed people, which we don't, and if we don't have a vast pool of farm workers who are being driven into manufacturing by productivity gains in the farm sector, or being attracted by higher wages, then where these workers have to come from to produce these new goods that were previously imported is from our exportable sector. And that's going to reduce exports. It's going to hurt manufacturing employment when these workers come out of manufacturing. So, it's hard to see how this idea can possibly work. I mean, if you push people of a populist persuasion who are in tune with Cass' argument, they'll say things like, well, you know, the reason we don't have more manufacturing workers is they've dropped out of the labor force because they've been discouraged by the absence of good jobs. If we create all these good jobs, then they'll come back. And so they're arguing that, well, there really is this group of people that's out there. Now, I think that's contested. I don't think it's substantiated. I think US participation has recently come up. In the U.S., we actually have drawn on a new source of workers in the Biden administration, which is immigration. Trump wants to deport upwards of 10 million workers. So, the program just doesn't really add up in my mind.

Michael Klein

So, Maury, you've addressed a lot of the issues that were raised in Cass' article and, as you say, populists raise as well, whether other policy tools would be more effective, the lack of really substantial revenues from a tariff, the problems of retaliation, the politics of tariffs, and what economists call rent seeking of people protecting their positions. Is there any role for tariffs that you see?

Maurice Obstfeld

Tariffs can play a legitimate role in a well-delineated set of cases relating to unfair trade policies by our partners, where they can be an appropriate response. For example, if a country that we trade with is unfairly subsidizing its exports in order to make them more competitive in our markets, thereby hurting our domestic industries, the WTO sanctions countervailing tariffs can be remedies against dumping by foreign countries. There are remedies in which tariffs can be available when there's a disruptive import surge that swamps certain industries, causing high levels of unemployment and leaving little time for the firms and the workers to adjust. So, in the realm of trade policy, there's a recognized but limited role for tariffs, but tariffs as an industrial policy to bring back manufacturing, tariffs as a tool to increase our trade surplus, these are all unlikely to work, and likely to be destructive, especially when they're met with retaliation from our trade partners.

Michael Klein

So, Maury, as I said at the beginning, the title of the article you wrote with Kim is, "What Populists Don't Understand About Tariffs (but economists do)." So, in our conversation today, I think you helped people beyond economists understand about tariffs. So, thank you very much for coming on to the podcast and explaining this very important issue.

Maurice Obstfeld

It's been a pleasure, as always, Michael. Take care.

Michael Klein

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