Trump's tariffs

Joe McGarrity

Economists agree on more than you might think. For instance, they agree that tariffs lead to higher prices and lower economic growth.

Tariffs cause higher prices because they reduce the incentive domestic producers have to keep their prices low. For example, when the U.S. imposed a 25 percent tariff on steel, like we saw in the first Trump administration, foreign steel producers had to pay a 25 percent tax when they sold their steel in the U.S. These foreign firms passed most of this extra cost along to the U.S. firms who purchased foreign steel. As foreign steel producers increased their prices, U.S. steel producers were able to get away with raising their steel prices. Foreign steel producers could no longer undercut these higher prices because they had to pay the 25 percent tax. Further, since the price of all steel sold in the U.S. increased, regardless of whether it was produced at home or abroad, firms that bought steel had higher production costs. GM had to pay more to produce a car and construction companies had to pay more to produce high-rise buildings. These companies, then, passed their higher input costs on to consumers by raising their prices. Cars and buildings became more expensive.

In the first Trump administration, higher tariffs were placed on steel and aluminum (and a few other goods). In his second administration, he plans an across the board increase in tariffs so the impact on prices will be greater. Any goods that are produced abroad or any goods produced in the U.S. using the inputs subject to Trump's tariffs will become more expensive.

Tariffs will reduce our economic growth because they encourage us to use our resources inefficiently. Take the tariff on steel. Since foreign steel producers must charge higher prices, domestic producers will be able to undercut the foreign sellers' prices and sell more steel. But this expanded steel production in the U.S. will cause the U.S. to devote too many resources to steel production. Instead, we could have produced some other product with less resources, one that we do not import from other countries. Then, we could trade this other good for steel and use the resources we saved to produce additional output.

So you can see, from an economic standpoint, the case against tariffs is clear. But there might be a reasonable political case in favor of tariffs. If the U.S. believes that China is an adversary, then we might not want to have free trade with them. While the U.S.'s economy will suffer from this policy, China's economy will suffer even more – especially if the U.S. and its allies adopt the same tariff policies toward China. In that case, China would lose access to a huge market and the U.S would only lose access to the smaller Chinese market. But this argument can only be used to justify tariffs against China, not the across-the-board tariffs that Trump advocates.

Economists often fall into the trap of advocating policies that are economically efficient but politically impossible or politically undesirable. Given that political goals often get more weight than economic goals, economists need to make recommendations that lead to the best outcomes given the constraints of the stated political goals. In this case, economists might try to convince Trump to drop his across-the-board tariffs and replace them with tariffs on Chinese goods.

Joe McGarrity is a Professor of Economics at UCA. He can be reached at joem@uca.edu.