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Who's "Protected" by Tariffs?

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[Chapter 11 of Economics in One Lesson [2].]

A mere recital of the economic policies of governments all over the world is calculated to cause any serious student of economics to throw up his hands in despair. What possible point can there be, he is likely to ask, in discussing refinements and advances in economic theory, when popular thought and the actual policies of governments, certainly in everything connected with international relations, have not yet caught up with Adam Smith? For present- day tariff and trade policies are not only as bad as those in the seventeenth and eighteenth centuries, but incomparably worse. The real reasons for those tariffs and other trade barriers are the same, and the pretended reasons are also the same.

In the century and three-quarters since *The Wealth of Nations* appeared, the case for free trade has been stated thousands of times, but perhaps never with more direct simplicity and force than it was stated in that volume. In general Smith rested his case on one fundamental proposition: "In every country it always is and must be the interest of the great body of the people to buy whatever they want of those who sell it cheapest." "The proposition is so very manifest," Smith continued, "that it seems ridiculous to take any pains to prove it; nor could it ever have been called in question, had not the interested sophistry of merchants and manufacturers confounded the commonsense of mankind."

From another point of view, free trade was considered as one aspect of the specialization of labor:

It is the maxim of every prudent master of a family, never to attempt to make at home what it will cost him more to make than to buy. The tailor does not attempt to make his own shoes, but buys them of the shoemaker. The shoemaker does not attempt to make his own clothes, but employs a tailor. The farmer attempts to make neither the one nor the other, but employs those different artificers. All of them find it for their interest to employ their whole industry in a way in which they have some advantage over their neighbors, and to purchase with a part of its produce, or what is the same thing, with the price of a part of it, whatever else they have occasion for. What is prudence in the conduct of every private family can scarce be folly in that of a great kingdom.

But whatever led people to suppose that what was prudence in the conduct of every private family *could* be folly in that of a great kingdom? It was a whole network of fallacies, out of which mankind has still been unable to cut its way. And the chief of them was the central fallacy with which this book is concerned. It was that of considering merely the immediate effects of a tariff on special groups, and neglecting to consider its long-run effects on the whole community.

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An American manufacturer of woolen sweaters goes to Congress or to the State Department and tells the committee or officials concerned that it would be a national disaster for them to remove or reduce the tariff on British sweaters. He now sells his sweaters for $15 each, but English manufacturers could sell here sweaters of the same quality for $10. A duty of $5, therefore, is needed to keep him in business. He is not thinking of himself, of course, but of the thousand men and women he employs, and of the people to whom their spending in turn gives employment. Throw them out of work, and you create unemployment and a fall in purchasing power, which would spread in ever-widening circles. And if he can prove that he really would be forced out of business if the tariff were removed or reduced, his argument against that action is regarded by Congress as conclusive.

But the fallacy comes from looking merely at this manufacturer and his employees, or merely at the American sweater industry. It comes from noticing only the results that are immediately seen, and neglecting the results that are not seen because they are prevented from coming into existence.

The lobbyists for tariff protection are continually putting forward arguments that are not factually correct. But let us assume that the facts in this case are precisely as the sweater manufacturer has stated them. Let us assume that a tariff of $5 a sweater is necessary for him to stay in business and provide employment at sweater making for his workers.

We have deliberately chosen the most unfavorable example of any for the removal of a tariff. We have not taken an argument for the imposition of a new tariff in order to bring a new industry into existence, but an argument for the retention of a tariff *that has already brought an industry into existence,* and cannot be repealed without hurting somebody.

The tariff is repealed; the manufacturer goes out of business; a thousand workers are laid off; the particular tradesmen whom they patronized are hurt. This is the immediate result that is seen. But there are also results which, while much more difficult to trace, are no less immediate and no less real. For now sweaters that formerly cost $15 a piece can be bought for $10. Consumers can now buy the same quality of sweater for less money, or a much better one for the same money. If they buy the same quality of sweater, they not only get the sweater, but they have $5 left over, which they would not have had under the previous conditions, to buy something else. With the $10 that they pay for the imported sweater they help employment—as the American manufacturer no doubt predicted—in the sweater industry in England. With the $5 left over they help employment in any number of other industries in the United States.

But the results do not end there. By buying English sweaters they furnish the English with dollars to buy American goods here. This, in fact (if I may here disregard such complications as multilateral exchange, loans, credits, gold movements, etc. which do not alter the end result) is the only way in which the British can eventually make use of these dollars. Because we have permitted the British to sell more to us, they are now able to buy more from us. They are, in fact, eventually *forced* to buy more from us if their dollar balances are not to remain perpetually unused. So, as a result of letting in more British goods, we must export more American goods. And though fewer people are now employed in the American sweater industry, more people are employed—and much more efficiently employed—in, say, the American automobile or washing-machine business. American employment on net balance has not gone down, but American and British production on net balance has gone up. Labor in each country is more fully employed in doing just those things that it does best, instead of being forced to do things that it does inefficiently or badly. Consumers in both countries are better off. They are able to buy what they want where they can get it cheapest. American consumers are better provided with sweaters, and British consumers are better provided with motor cars and washing machines.

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Now let us look at the matter the other way round, and see the effect of imposing a tariff in the first place. Suppose that there had been no tariff on foreign knit goods, that Americans were accustomed to buying foreign sweaters without duty, and that the argument were then put forward that we could *bring a sweater industry into existence* by imposing a duty of $5 on sweaters.

There would be nothing logically wrong with this argument so far as it went. The cost of British sweaters to the American consumer might thereby be forced so high that American manufacturers would find it profitable to enter the sweater business. But American consumers would be forced to subsidize this industry. On every American sweater they bought they would be forced in effect to pay a tax of $5 which would be collected from them in a higher price by the new sweater industry.

Americans would be employed in a sweater industry who had not previously been employed in a sweater industry. That much is true. But there would be no net addition to the country's industry or the country's employment. Because the American consumer had to pay $5 more for the same quality of sweater he would have just that much less left over to buy anything else. He would have to reduce his expenditures by $5 somewhere else. In order that one industry might grow or come into existence, a hundred other industries would have to shrink. In order that 20,000 persons might be employed in a sweater industry, 20,000 fewer persons would be employed elsewhere.

But the new industry would be *visible*. The number of its employees,the capital invested in it, the market value of its product in terms of dollars, could be easily counted. The neighbors could see the sweater workers going to and from the factory every day. The results would be palpable and direct. But the shrinkage of a hundred other industries, the loss of 20,000 other jobs somewhere else, would not be so easily noticed. It would be impossible for even the cleverest statistician to know precisely what the incidence of the loss of other jobs had been—precisely how many men and women had been laid off from each particular industry, precisely how much business each particular industry had lost—because consumers had to pay more for their sweaters. For a loss spread among all the other productive activities of the country would be comparatively minute for each. It would be impossible for anyone to know precisely how each consumer *would* have spent his extra $5 if he had been allowed to retain it. The overwhelming majority of the people, therefore, would probably suffer from the optical illusion that the new industry had cost us nothing.

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It is important to notice that the new tariff on sweaters would not raise American wages. To be sure, it would enable Americans to work *in the sweater industry* at approximately the average level of American wages (for workers of their skill), instead of having to compete in that industry at the British level of wages. But there would be no increase of American wages *in general* as a result of the duty; for, as we have seen, there would be no net increase in the number of jobs provided, no net increase in the demand for goods, and no increase in labor productivity. Labor productivity would, in fact, be *reduced* as a result of the tariff.

And this brings us to the real effect of a tariff wall. It is not merely that all its visible gains are offset by less obvious but no less real losses. It results, in fact, in a net loss to the country. For contrary to centuries of interested propaganda and disinterested confusion, the tariff *reduces* the American level of wages. Let us observe more clearly how it does this. We have seen that the added amount which consumers pay for a tariff-protected article leaves them just that much less with which to buy all other articles.

There is here no net gain to industry as a whole. But as a result of the artificial barrier erected against foreign goods, American labor, capital and land are deflected from what they can do more efficiently to what they do less efficiently. Therefore, as a result of the tariff wall, the average productivity of American labor and capital is reduced. If we look at it now from the consumer's point of view, we find that he can buy less with his money. Because he has to pay more for sweaters and other protected goods, he can buy less of everything else. The general purchasing power of his income has therefore been reduced. Whether the net effect of the tariff is to lower money wages or to raise money prices will depend upon the monetary policies that are followed. But what is clear is that the tariff—though it may increase wages above what they would have been in *the protected industries*— must on net balance, when *all* occupations are considered, *reduce real wages.*

Only minds corrupted by generations of misleading propaganda can regard this conclusion as paradoxical. What other result could we expect from a policy of deliberately using our resources of capital and manpower in less efficient ways than we know how to use them? What other result could we expect from deliberately erecting artificial obstacles to trade and transportation?

For the erection of tariff walls has the same effect as the erection of real walls. It is significant that the protectionists habitually use the language of warfare. They talk of "repelling an invasion" of foreign products. And the means they suggest in the fiscal field are like those of the battlefield. The tariff barriers that are put up to repel this invasion are like the tank traps, trenches, and barbed-wire entanglements created to repel or slow down attempted invasion by a foreign army.

And just as the foreign army is compelled to employ more expensive means to surmount those obstacles—bigger tanks, mine detectors, engineer corps to cut wires, ford streams, and build bridges—so more expensive and efficient transportation means must be developed to surmount tariff obstacles. On the one hand, we try to reduce the cost of transportation between England and America, or Canada and the United States, by developing faster and more efficient ships, better roads and bridges, better locomotives and motor trucks. On the other hand, we offset this investment in efficient transportation by a tariff that makes it commercially even more difficult to transport goods than it was before. We make it $1 cheaper to ship the sweaters, and then increase the tariff by $2 to prevent the sweaters from being shipped. By reducing the freight that can be profitably carried, we reduce the value of the investment in transport efficiency.

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The tariff has been described as a means of benefiting the producer at the expense of the consumer. In a sense this is correct. Those who favor it think only of the interests of the producers immediately benefited by the particular duties involved. They forget the interests of the consumers who are immediately injured by being forced to pay these duties. But it is wrong to think of the tariff issue as if it represented a conflict between the interests of producers as a unit against those of consumers as a unit. It is true that the tariff hurts all consumers as such. It is not true that it benefits all producers as such. On the contrary, as we have just seen, it helps the protected producers at the expense of all other American producers, *and particularly of those who have a comparatively large potential export market.*

We can perhaps make this last point clearer by an exaggerated example. Suppose we make our tariff wall so high that it becomes absolutely prohibitive, and no imports come in from the outside world at all. Suppose, as a result of this, that the price of sweaters in America goes up only $5. Then American consumers, because they have to pay $5 more for a sweater, will spend on the average five cents less in each of a hundred other American industries. (The figures are chosen merely to illustrate a principle: there will, of course, be no such symmetrical distribution of the loss; moreover, the sweater industry itself will doubtless be hurt because of protection of still *other* industries. But these complications may be put aside for the moment.)

Now because foreign industries will find their market in America *totally* cut off, they will get no dollar exchange, and therefore they will be *unable to buy any American goods at all.* As a result of this, American industries will suffer in direct proportion to the percentage of their sales previously made abroad. Those that will be most injured, in the first instance, will be such industries as raw cotton producers, copper producers, makers of sewing machines, agricultural machinery, typewriters and so on.

A higher tariff wall, which, however, is not prohibitive, will produce the same kind of results as this, but merely to a smaller degree. The effect of a tariff, therefore, is to change the *structure* of American production. It changes the number of occupations, the kind of occupations, and the relative size of one industry as compared with another. It makes the industries in which we are comparatively inefficient larger, and the industries in which we are comparatively efficient smaller. Its net effect, therefore, is to reduce American efficiency, as well as to reduce efficiency in the countries with which we would otherwise have traded more largely.

In the long run, notwithstanding the mountains of argument pro and con, a tariff is irrelevant to the question of employment. (True, sudden *changes* in the tariff, either upward or downward, can create temporary unemployment, as they force corresponding changes in the structure of production. Such sudden changes can even cause a depression.) But a tariff is not irrelevant to the question of wages. In the long run it always reduces real wages, because it reduces efficiency, production and wealth.

Thus all the chief tariff fallacies stem from the central fallacy with which this book is concerned. They are the result of looking only at the immediate effects of a single tariff rate on one group of producers, and forgetting the long-run effects both on consumers as a whole and on all other producers.

(I hear some reader asking: "Why not solve this by giving tariff protection to *all* producers?" But the fallacy here is that this cannot help producers uniformly, and cannot help at all domestic producers who already "outsell" foreign producers: these efficient producers must necessarily suffer from the diversion of purchasing power brought about by the tariff.)

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On the subject of the tariff we must keep in mind one final precaution. It is the same precaution that we found necessary in examining the effects of machinery. It is useless to deny that a tariff does benefit—or at least *can* benefit —*special interests*. True, it benefits them *at the expense of everyone else*. But it does benefit them. If one industry alone could get protection, while its owners and workers enjoyed the benefits of free trade in everything else they bought, that industry would benefit, even on net balance. As an attempt is made to *extend* the tariff blessings, however, even people in the protected industries, both as producers and consumers, begin to suffer from other people's protection, and may finally be worse off even on net balance than if neither they nor anybody else had protection.

But we should not deny, as enthusiastic free traders have so often done, the possibility of these tariff benefits to special groups. We should not pretend, for example, that a reduction of the tariff would help everybody and hurt nobody. It is true that its reduction would help the country on net balance. But *somebody* would be hurt. Groups previously enjoying high protection would be hurt. That in fact is one reason why it is not good to bring such protected interests into existence in the first place. But clarity and candor of thinking compel us to see and acknowledge that some industries are right when they say that a removal of the tariff on their product would throw them out of business and throw their workers (at least temporarily) out of jobs. And if their workers have developed specialized skills, they may even suffer permanently, or until they have at long last learnt equal skills. In tracing the effects of tariffs, as in tracing the effects of machinery, we should endeavor to see *all* the chief effects, in both the short run and the long run, on *all* groups.

As a postscript to this chapter I should add that its argument is not directed against *all* tariffs, including duties collected mainly for revenue, or to keep alive industries needed for war; nor is it directed against all arguments for tariffs. It is merely directed against the fallacy that a tariff on net balance "provides employment," "raises wages," or "protects the American standard of living." It does none of these things; and so far as wages and the standard of living are concerned, it does the precise opposite. But an examination of duties imposed for other purposes would carry us beyond our present subject.

Nor need we here examine the effect of import quotas, exchange controls, bilateralism, and other devices in reducing, diverting or preventing international trade. Such devices have, in general, the same effects as high or prohibitive tariffs, and often worse effects. They present more complicated issues, but their net results can be traced through the same kind of reasoning that we have just applied to tariff barriers.

Image credit. [3]

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