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FREE EXPRESSION

If Trump's Tariffs Are So Bad, Where's the Recession?

Donald Trump's trade policy is in danger of demonstrating the truth about one of those old definitions of an economist: someone who sees something working in practice and explains why it will never work in theory.

We have been told, by adherents of diverse creeds of the dismal pseudoscience, that the president's sweeping tariff plans would be a short route to economic disaster: Smoot-Hawley, the Sequel. Set aside that the infamous 1930 legislation was probably only a mere contributor to the calamity that followed rather than its author, the history and received wisdom are clear, premised on basic economic principles: Tariffs are a tax that have especially adverse consequences—increasing prices paid by importers and, ultimately, consumers; and, because of the income effect of a tax rise, at the same time depressing demand.

But even as the U.S. has been transformed in just six months into a high-tariff economy, there is scant sign of the economic disaster we were promised. Deals signed in the past week with two of our largest trading partners indicate that a 15% tariff is now the likely new floor for most U.S. imports, with higher duties still in place on some goods.

Yet economists surveyed by the Journal this month estimate the economy grew by about 2% in the second quarter, accelerating out of the first three months of the year. They think the odds of a recession in the next year are just 1 in 3. Core inflation remains below 3%, down from 3.5% at the end of last year. Equity markets are reaching new highs as investors have recovered from their panic attack of April.

Having broken most of the rules of politics, has Mr. Trump really smashed one of the supposedly iron laws of economics too?

#1

There are three possible answers: First, it's too early to tell. Most of the tariffs announced haven't been in place long. Strangely enough, the uncertainty from Mr. Trump's dizzying policy changes that was expected to have been especially destabilizing may be helping soften the blow. If importers aren't sure whether announced duties will stay or change, they may be holding off on big price increases until they have clarity. And as we saw with the outcome of the U.S.-Japan deal last week, when the actual tariff levels come in lower than the worst fears, the psychological effect can be positive; that odd feeling of contentment you get when you discover that the $100 bill you thought you had dropped on the sidewalk was only a $20. Note

But still, for all the unclarity, the average tariff paid by importers has indeed risen sharply—to more than 15%, up from less than 3% a year ago, so far with limited adverse consequences.

#2

Which leads us to the second possibility— the tariffs thus far have just not been big enough to cause the harm economists warned us about from full-on protectionism. The U.S. is a relatively closed economy, with imports accounting for less than 15% of gross domestic product. Perhaps the U.S. economy is simply resilient enough to withstand even bad policy, more capable of withstanding a moderate tariff shock. Note

But this is incomplete. The average 15% tariff rate now is historically large; five times the level that prevailed previously, it is close to the average rate of around 20% on all imports under Smoot-Hawley. If the economy were simply to shrug off that level of protection, could it be that we are missing something?

So third, #③ and tantalizingly, perhaps the conventional wisdom is wrong. Or, more precisely, since no one can deny the effect of taxes are real, perhaps, in their rush to emphasize the negatives, economists have overlooked the countervailing forces at work with tariffs: The redistribution of the burden of duties between foreign exporters, U.S. importers and consumers may be reordering the balance of benefit between domestic and foreign businesses and between companies and consumers. Federal tariff revenue up to $300 billion a year will produce gains for Americans. The relative advantage of doing business in the U.S. may, as promised, start to be reflected in stronger inward investment flows. The strikingly onesided deal Mr. Trump just inked with the European Union certainly suggests the sheer economic muscle of the U.S. has been previously under- utilized in opening up markets overseas.

At this point, only the first answer can be given in confidence: It is too early to tell. But if the second or third turns out to be true, if the U.S. shrugs off or even gains from its embrace of protectionism, it will represent another blow to the already battered reputation of what was recently the West's so-called economic consensus.

The 2007-08 global financial crisis and its aftermath shattered faith in the post-Cold War economic certainties, the idea that human history had reached some ideological endpoint of progress. Collapsing faith in the democratic institutions of the West in the years since has shattered similar faith in the enduring supremacy of Western liberalism. If the world's largest economy can run supposedly discredited economic policies and still thrive, the policy orthodoxies of most of the past half century will have been shattered too. The rising voices of those who argue for a nationalist, statist, corporatist governing program will be able to add a dose of empirical evidence to their ideological arguments, as theory once again races to catch up with practice.

By Gerard Baker

