Fall 9-20-2018

Economics 101: Tariffs and Trade

Rod Mabry
University of Texas at Tyler, hibbsinstitute@uttyler.edu

Manuel Reyes-Loya
University of Texas at Tyler

UT TYLER SOULES COLLEGE of BUSINESS
Hibbs Institute for Business and Economic Research

Hibbs Brief
Economics for Daily Use

September 20, 2018.

Hibbs Institute for Business and Economic Research

Hibbs Brief items are intended to clarify current issues for busy leaders, using economic principles and relevant data.

Hibbs Institute Services:

- East Texas Data
- Economic Impact Analyses
- Business Development Analysis
- Labor Market Analysis
- Feasibility Studies
- Project Evaluation
- Secondary Data Analysis

Website:
www.uttyler.edu/cbt/hiber

Email Address:
HibbsInstitute@uttyler.edu

Ph.#:
903.566.7365

Economics 101: Tariffs and Trade

Dr. Rod Mabry
Dr. Manuel Reyes-Loya

Basic economics tells us trade with others benefits all. That is the basis for us being economists and you being a barber, banker, manager, or oil man. We all specialize according to our talents, work preferences, and available resources. We then work hard and trade the goods and services we produce. Specializing, rather than producing our own food, our own clothes and our own houses, allows us to become much more efficient producers. That added efficiency results in much higher total output, lower prices and higher incomes.

The same is true with specialization and trade between countries—which is a misnomer because all trade occurs between people and the firms they organize, not countries. World output and total income flowing to people are higher.

Tariffs, whether put in place to raise income for government or to protect an industry, distort business production decisions and thwart or reduce efficiency gains. Tariffs, therefore, always lower total output, raise prices and lower total income.

So, why are we in the middle of what some call tense trade agreement re-negotiations and others call trade wars? One important reason is that many people mistakenly place too much emphasis on an accounting construction called the balance of payments. Some people say the U.S. buys a great deal from China and that people in that country should, in the name of fairness, return the favor and buy the same amount from us—making our payments to each other balance. But, there is no reason for individual country-to-country "balance of payments" to be in balance. In fact, there is every economic reason to believe they should not be in balance. People in China may prefer to buy some rice from Japan and some steel from Germany in addition to the goods and services they buy from U.S. firms. In turn, people in the other countries (from whom China buys) would then buy something from U.S. producers.

A friend and mentor of Dr. Mabry's, Dr. Bruce Yandle[i], humorously reminded us recently that trade imbalances between specific countries almost always exist and constitute a red herring. He wrote that as a customer he might have a very hard time getting his barber to return his favor by buying some economic research services from Yandle! The value of services traded between seller and customer will almost never balance.

Returning to trading nations, we can assure you that, sooner or later, the people in China from whom Americans have bought things will want to buy U.S. goods and services with the U.S. dollars they receive, or still other countries from whom Chinese people buy things instead will want to. If that were not so, then these foreign companies and workers would have given us their products, their real output—Chinese-made iPhones, Indonesian-made Nike clothes, Sweden's Husqvarna mowers and French Airbus airliners—for paper (or digital) dollars gathering dust in warehouses (or digital files) not ever to be used. That is a fairy tale.

Of course, the devil is in the details. If a country's overall balance of payments, or overall balance of trade with all its partners combined, remains unequal, the value of its currency relative to the currencies of its trading partners will rise or fall (making its products cheaper or more dear), thereby bringing trade into balance over a longer period. International trade imbalances are mostly self-correcting.

Stay tuned for more insight into the Alice-in-Wonderland world of tariffs and trade. Next time, we will tackle another argument often used today to justify re-working U.S. trade agreements. That argument says new trade treaties are needed to bring back the factory jobs of yesteryear in rust-belt states and elsewhere in our country.

[i] Dr. Bruce Yandle is a hero of ours who continues to pen wonderful, scholarly work for the Mercatus Center at George Mason University.