"Outdoing Smoot-Hawley"

by Milton Friedman
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The Smoot-Hawley Tariff Act has come to symbolize protectionism run mad. It has been blamed for both the 1929 stock-market crash and the subsequent Depression. In my view, that gives it too much "credit." However, it did impose heavy costs on the American consumer, did deepen the Depression, and did usher in a decade of "beggar-thy-neighbor policies" around the world.

Malcolm Baldrige, secretary of commerce throughout the Reagan administration; William Brock, the first trade negotiator of the Reagan administration and currently secretary of labor; and, more recently, Clayton Yeutter, the current trade negotiator, have been making Smoot-Hawley look positively benign. Despite the harm it did, Smoot-Hawley had at least one virtue—the tariffs it imposed did yield revenue to the Treasury.

The blatantly protectionist measures that have been fostered by Messrs. Baldrige, Brock and Yeutter in response to pressures from both business and labor unions do not have even that virtue.

The first major monstrosity was the so-called voluntary restraints on imports of Japanese cars, imposed to "save" the U.S. auto industry. That measure—supposedly temporary but still in effect after six years—has not saved the U.S. auto industry, though it has conferred great benefits on some U.S. companies, notably Chrysler. Japanese cars built in U.S. factories, and Japanese engines and other parts incorporated in cars misleadingly labeled "U.S.-built," have increasingly been supplementing direct imports. Ford, currently the most profitable and strongest U.S. auto company, owes its success largely to its overseas, not domestic, activities.

The "voluntary" restraints in effect legitimized a government-enforced cartel of Japanese auto producers, enabling them to limit sales, raise prices and pocket the difference. Messrs. Baldrige, Brock and Yeutter patted themselves on the back for an arrangement that if undertaken by U.S. enterprises would have been illegal, has cost U.S. consumers billions of dollars in higher prices for both U.S. and Japanese cars, has weakened the U.S. industry and generated profits for Japanese car companies—and has not produced even one dollar in U.S. government revenue.

In 1985, the administration favored the end of the restraints. But by then the Japanese had discovered what a good thing "Voluntary" restraints were for them, and so have continued them on their own.

The first monstrosity has been followed by a succession of others: "voluntary" restraints on steel and textile imports; subsidies to agricultural exports; tightened sugar quotas; higher tariffs on Canadian lumber; a threat of prohibitive tariffs on imports from the Common Market, and on and on. A fig leaf for the professed free-trade policy of the administration has been provided by an occasional rejection of a request for a higher tariff or an import quota.

The most recent monstrosity is with respect to microchips. After engineering a cartel between Japanese and U.S. chip makers—again something clearly illegal if done by domestic companies alone—Messrs. Baldrige and Yeutter profess to be outraged that, like most cartel agreements, it proved to be a leaky sieve—fortunately, I may add. In retaliation, they threatened heavy tariffs against Japanese electronic products, which they have now reluctantly imposed, while broadcasting their intention that the tariffs last only until they have succeeded in bludgeoning Japan into enforcing the cartel agreement on its own firms. If successful, that would lead to the transfer of microchip production to areas other than the U.S. and the Japanese microchip industries. An OPEC in microchips at the demand of the customers! It boggles the imagination.

The excuse offered by President Reagan for approving these protectionist measures has been that if the administration did not adopt them, Congress would pass even more extreme protectionist measures. Poor excuse. The president retains his veto power. While Congress might have overridden some of his vetoes, it would have been clear where the blame lay. As it is, the administration has given members of Congress—of both parties—a free ride. They enjoy the luxury of supporting special interests always eager for restraints on their competitors while avoiding the responsibility for imposing higher costs on consumers. The result has been an escalation in protectionist rhetoric.

Congress and the administration are fond of describing the U.S. as an oasis of free trade, beleaguered by the protectionist measures of Japan and others. All we ask for, they say, is a level playing field. This is fiction. True, Japan erects many barriers to imports. In doing so they harm themselves and the U.S. But the U.S. is far from blameless. U.S. restraints on trade are every bit as egregious as Japan’s.

The U.S., too, imposes high tariffs and imposes numerous quotas on imports. Japanese consumers of meat pay three to four times the world price of meat; U.S. consumers of sugar pay three to four times the world price of sugar. Japan subsidizes some exports. The U.S. subsidizes some exports and also prohibits the export of oil from Alaska and of timber cut on national forest lands. It is estimated that eliminating these two restraints alone would cut in half the bilateral trade deficit between Japan and the U.S. Physician, heal thyself.

Ronald Reagan is a strong supporter of the principle of free trade. His rhetoric has been admirable—both on the general issue and on the specific question of retaliation. I recall a splendid speech he gave in San Francisco some years ago in which he used the image of several people in a boat at sea. One of them shoots a hole in the bottom of the boat. Is the appropriate response of the others to shoot retaliatory holes? The image is exact. Yet his administration has been shooting retaliatory holes in the international trade boat for years, doing harm to the U.S. and to other countries.

The irony is that these actions have been offsetting some of the good effects of President Reagan’s domestic policies. Lower tax rates, restraint in government spending, privatization of government activities, and deregulation and reduced controls over prices and wages have strengthened market forces. Combined with the president’s support early in his administration for monetary restraint, these policies deserve much of the credit for the excellent performance of the U.S. economy in recent years—continued growth in output and employment plus lower inflation and interest rates. The record would have been still more remarkable if freer trade at home had been accompanied by freer trade abroad.

More important, unless the protectionist momentum is soon checked, the world may face another decade of beggar-thy-neighbor policies at a time when the web of international trade is far more closely knit than in the 1930s.

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