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Protectionism is Failing and Wrongheaded: An Evaluation of the Post-2017 Shift toward Trade Wars and Industrial Policy

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Introduction

The past two presidential administrations have enthusiastically embraced protectionism in their trade policies, marking a significant departure from the bipartisan consensus of recent decades that supported trade liberalization and free-market economics. In this paper, Michael Strain argues that the turn to protectionist and nationalist economic policies has been ineffective by its own standards, failing to raise employment and reduce America's reliance on China. Moreover, this approach is fundamentally misguided. Economic policymakers should focus on connecting workers to opportunities created from open trade, rather than enacting protectionist policies and attempting to recreate jobs of the past.

1. Protectionism Has Not Met Its Own Goals

The 2018–2019 Tariffs Likely Reduced Manufacturing Employment. Manufacturing employment has been on a downward trajectory since the end of World War II, with no significant changes observed following China's entry into the WTO or the adoption of protectionist policies. Researchers looking at the effects of Trump's 2018 tariffs have found that the protection from import competition those tariffs provided was outweighed by two effects: the increased price of intermediate goods and the retaliatory tariffs that other countries imposed on US goods. They found that industries more exposed to tariff increases experienced greater declines in employment. Beyond the manufacturing sector, counties with higher exposure to tariffs experienced higher unemployment rates.

Post 2017 Protectionism Did Not Reduce the US Trade Deficit. Although reducing the trade deficit was a primary goal of the Trump administration, protectionist measures did not accomplish this goal. The current account deficit, which measures the balance on trade in goods and in services, along with income flows between domestic and foreign residents, rose from $85.5 billion when President Trump took office to $180 billion at the end of his term.

Post-2017 Protectionism Did Not Reduce America's Reliance on China. The extensive tariff regime established in 2017 did reduce the bilateral trade deficit in goods with China by 17.9 percent between 2017 and 2020. However, this deficit fell because Chinese manufacturers rerouted goods through other nations, such as Mexico and Vietnam, to evade US tariffs. Indeed, even as the bilateral trade deficit fell between 2017 and 2020, China's "value added" to US domestic final demand (the amount Chinese firms contribute to goods purchased by US households, businesses, or governments) rose. In this way, protectionist policies did not reduce the economic linkages between China and the US.

2. Protectionism is Wrongheaded

The goal of significantly increasing manufacturing employment is inherently misguided. The decline in US manufacturing jobs largely reflects productivity gains. Although these productivity gains have been accompanied by disruptions, they also have created new opportunities. For instance, between 2000 and 2018, there has been a rise of "new middle" occupations that provide a pathway to the middle class. Policymakers should focus on doing more to help affected workers access these new opportunities rather than on trying to turn back the clock. While a narrow set of specific goods exists for which national security concerns warrant special attention, it is a long leap to specifically require these goods to be produced domestically. Instead, diversifying production across US allies could more effectively enhance economic resilience.

Trump's objective of eliminating the trade deficit is ill-advised. The trade deficit is conventionally attributed to the savings and investment decisions of US households and businesses, not to foreign governments blocking US exports or subsidizing their own. The US spends more than it produces and invests more than it can finance through national savings, which by definition implies a current account deficit. More fundamentally, eliminating the trade deficit would not increase employment in the United States (as discussed below.) Moreover, foreign direct and portfolio investments positively impact US wages and productivity. Economic engagement with other nations fosters global peace and prosperity, contributing to financial liquidity and economic interdependence. While there is legitimate concern about the debt levels required to finance a large trade deficit, the best way to address such concerns is through negotiating better access to export markets and pressuring nations with current account surpluses not to manipulate their currencies.

Free trade is not about jobs. Trade is not about jobs per se. Rather, trade is about productivity, wages, and consumption. Trade between nations allows a given nation to specialize in the production of those goods and services for which that nation has a comparative advantage, and to trade to receive and consume other goods and services – ultimately leading to an increase in world consumption.

Trade need not affect the overall number of jobs. Evidence from the "China shock"—the sudden expansion of trade caused by China's accession to the World Trade

Organization in 2000—bears out such a point empirically. Economists have found that the job losses caused by increased Chinese import competition were fully offset by the employment gains resulting from increased US exports.

Trade creates both winners and losers. While trade should not affect the aggregate level of employment, it affects the composition of jobs in the US labor market, in ways that disadvantage some workers and benefit others. This dynamic creates winners and losers, and the impacts on communities differ. Furthermore, experience has taught us that workers specialized in a sector with declining opportunities struggle to retrain and transition to new sectors with growing opportunities. Geographic mobility exacerbates these challenges, as workers are often unwilling to relocate from regions with declining opportunities to areas with expanding job prospects. But these challenges should not point policymakers in the direction of protectionist trade measures; rather, they should underscore the importance of providing economic opportunities to workers displaced by trade.

3. Industrial Policy is (almost) Always Bad Policy

Strain defines industrial policy as government intervention to override market outcomes with the goal of promoting a politically favored industry. Sometimes such intervention can be effective, as in the case of Operation Warp Speed, which aimed to develop, manufacture, and distribute COVID-19 vaccines. However, Operation Warp Speed had some particular features that set it up for success. For instance, it had a clearly defined goal and was plausibly achievable ex-ante. Such opportunities are few and far between.

Current industrial policy efforts under the Biden administration—the CHIPS and Science Act and the IRA—have multiple, competing objectives and are unlikely to yield public benefits that exceed the public costs. Furthermore, it is not clear that the domestic capacity to execute these efforts currently exists.

To advance American innovation, the government should invest public funds in basic research and infrastructure. The goal of this investment should not be to create manufacturing jobs and should not target specific products (like semiconductors) or specific goals for sectors (like clean energy). Instead, the goal should be to increase innovation and dynamism more broadly, which in turn will increase productivity and wage growth.

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Michael R. Strain is Director of Economic Policy Studies and Arthur F. Burns Scholar in Political Economy at the American Enterprise Institute. An economist, Dr. Strain's research and writing is in a wide range of areas, including labor markets, public finance, social policy, and macroeconomics. He has published over 40 articles in academic and policy journals. He is the author of the book *The American Dream Is Not Dead (But Populism Could Kill It)*, which examines longer-term economic outcomes for workers and households, and he is the editor or coeditor of four volumes on economics and public policy. He is Professor of Practice at Georgetown University; a research fellow with the Institute for the Study of Labor (IZA) in Bonn; a research affiliate with the Institute for Research on Poverty at the University of Wisconsin, Madison; and a member of the Aspen Economic Strategy Group. He is an elected member of the National Academy of Social Insurance. He was a member of the AEI-Brookings Working Group on Poverty and Opportunity, which published the report *Opportunity, Responsibility, and Security: A Consensus Plan for Reducing Poverty and Restoring the American Dream*. He has written over 300 articles for general audiences, and his essays and commentaries have been published by the *Financial Times*, the *New York Times*, the *Wall Street Journal*, and the *Washington Post*, among others. He is a columnist for Project Syndicate. A frequent guest on radio and television, Dr. Strain is regularly interviewed by broadcast news networks, including CNBC and NPR. He has testified before Congress and speaks often to a variety of audiences. Before joining AEI, Strain worked at the US Census Bureau and the Federal Reserve Bank of New York. He holds a PhD in economics from Cornell and lives in Washington, DC.