COMMERCE & TRADE

Putting 97 Million Households through the Wringer

By imposing "safeguard" tariffs, President Trump has delivered corporate welfare at the expense of American consumers.

BY PIERRE LEMIEUX

In January, President Trump announced that he is imposing customs tariffs of up to 50% on imported residential washing machines and 30% on solar panels and modules. Authority for those actions comes from the so-called "safeguard" provisions of Section 201 of the Trade Act of 1974. Such safeguard actions do not require any claim of "unfair" trade practice such as dumping or subsidization, but only a finding of "serious injury or the threat thereof" to domestic industry. These measures are meant to give temporary "import relief," allowing domestic manufacturers "to make a positive adjustment to import competition," as Section 201 states.

Consider specifically the washing machine tariff (on which this article will focus). It is scheduled to be in force for three years, with the initial 50% tariff rate declining by a fifth each year. Aimed mainly at South Korean producers Samsung and LG, the safeguard action will mainly affect workers in Thailand and Vietnam, where the two companies currently manufacture most of their washing machines, but (according to information available at the time of this writing) workers in China and Mexico will also be affected.

TARIFFS AND PRICES

Foreign competition in domestic appliances, mainly from Asia, has been a boon for American consumers. Since 2001, when China joined the World Trade Organization (WTO), the average price of appliances purchased by American residents has decreased by 22%, while the total Consumer Price Index increased by 41%. Anybody who has bought home appliances over this period has seen the difference in his wallet. Now, the new tariff will benefit a relatively small group of workers and corporate shareholders at the expense of American households.

According to IBISWorld, a market research firm, some 2,400 American workers are employed in manufacturing clothes washers and dryers (estimate for 2016). They mainly work at a Whirlpool plant in Clyde, OH and a GE Appliances plant in Louisville, KY. The benefited shareholders hold stock in Whirlpool, which is listed on the New York Stock Exchange, and Haier Group, a Chinese company that purchased GE Appliances in early 2016 and is listed on the Shanghai Stock Exchange.

The new tariff will raise washing machine prices in the United States. Indeed, LG quickly announced a $50 price increase. Those increases won't be limited to LG and Samsung, though; reduced price competition pushes up the price on both the targeted goods and their competitors. There can be only one price on a market, account being duly taken of differences in features and in quality as evaluated by consumers.

One way to see this is as follows. If your competitors charge more because they have to pay a new tax, you will spend to increase your own production up to the point where the higher price justifies your higher (marginal) cost. This is why a tariff increases domestic production while it reduces imports. Of course, a company may want to increase market share, but it will not indefinitely

PIERRE LEMIEUX is an economist affiliated with the Department of Management Sciences at the Université du Québec en Outaouais. His new book, *What's Wrong with Protectionism?* is forthcoming from the Mercatus Center at George Mason University.

GETTY IMAGES

sacrifice profits to do so; and when imports are reduced, domestic producers can increase both market share and profits.

Look at it from another viewpoint. Domestic producers of washing machines had to cut their prices in order to meet foreign competition. As this competition softens, they can raise their prices.

Economic theory shows that, in the general case (a world market with elastic supply and a relatively small country that adopts the tariff), a tariff is paid not by foreign producers but by domestic consumers, as both foreign and domestic producers increase their prices by the full amount of the tariff. Lower supply calls for higher prices. Although foreign producers have to pay the tariff to the Treasury, payment will be offset by the higher prices they charge to consumers.

In the real-world case of Trump's tariff on washing machines, foreign producers will probably absorb some of the tariff—that is, they will not be able to add all of it to the price they charge American consumers. The reason for this is that the American market for washing machines is a large part of the world market, and lower American demand on this market will push the world price down. Foreign producers will not be able to replace American consumers by other consumers around the world and will therefore be willing to accept lower prices on their American sales—which they can do as they produce less and move down on their supply curve. This special case of a large country and market is referred to as the "optimal-tariff" or "terms-of-trade" argument in the economic literature.

But there is no doubt that American consumers will pay part of the tariff. Prices will increase or, equivalently, will not decrease as much as they would have otherwise. Goldman Sachs, an investment bank, forecasts that the price of washing machines will increase by 8%–20% during the first year. This is probably an underestimate and it would not be surprising if prices increase by at least 25%.

POOR ECONOMICS

Some 97 million American households have washing machines. Households that replace or add those appliances in the coming years will pay a large part, if not most, of the new tariff. The U.S. Trade Representative's press release on the tariff explains that "the Trump Administration will always defend American workers, farmers, ranchers, and businesses in this regard." The press release did not mention American consumers of washing machines, who constitute most of the U.S. population.

Technically, the safeguard measures take the form of a "tariff-rate quota." The first 1.2 million imported washing machines (less than 40% of current imports) will be charged a 20% tariff instead of 50%. (The tariff also extends to parts for washing machines. The first 50,000 parts in the first year will not be subjected to the tariff, rising to 90,000 in the third year.) A quota is equivalent to a tariff in that they both reduce the quantities imported and lead to higher prices. Under a quota, however, the foreign exporters will receive the "tax" revenue from the "tariff" because they will be charging higher prices for the now-scarcer good. Thus, part of the tariff-quota on washing machines amounts to a transfer from American consumers to the foreign producers.

Understanding why this provision was included in the Trump action helps to clarify the nature of protectionism. Tariffs are simply a way to transfer money from some people to others, to rob Peter to pay Paul. (See "Patriotism as Stealing from Each Other," Winter 2017–2018.) The transfer is generally from consumers to domestic producers, but political reasons sometimes require government to tweak the opaque redistribution. For example, foreign exporters may be less fervent in their opposition if they get part of the loot; a tariff-rate quota action is a good way to accomplish this. Foreign exporters are also more likely to invest in U.S. factories if they can import their parts duty free; this would give politicians a bit of job creation to tout and some ribbon-cutting publicity.

Still, Samsung—which recently began producing washing machines at a new $380 million plant in Newberry, SC—is not happy. Neither are South Carolina Republican Gov. Henry McMaster and other state leaders, who criticized the tariff publicly. South Carolina voters went for Trump by a 55%–41% margin over Democratic rival Hillary Clinton in 2016. Officials likely are also unhappy in Tennessee, where LG is building a washing machine plant in Clarksville. Tennessee voted for Trump 61%–35% over Clinton.

Whirlpool is the company that, in May 2017, petitioned the U.S. International Trade Commission (ITC) to recommend safeguard tariffs to the president. Whirlpool is a large international firm, headquartered in the United States, with worldwide revenues of $21 billion and net earnings of $928 million (in 2016). According to an IBISWorld report on the American market for clothes washers and dryers, Whirlpool's market share is 75% of domestic production and 40% of the whole domestic market (of which 53% is served by domestic producers).

In its January 25th issue, *The Economist* relates an interesting fact about Whirlpool: "When, in 2006, it merged with Maytag, a rival, it quelled concerns about its high market share by pointing to competition from abroad." Now apparently incapable of competing with Samsung and LG on the market, the company has been complaining of its declining market share and protesting to the U.S. government since 2012. In its safeguard petition to the ITC, the company shamelessly complains that import competition pushes prices down and reduces return on investment.

The company's rent-seeking should not be obscured by its profession of faith in "free and fair trade" and "healthy competition," or by its pretense of "social responsibility." In a section of its website called "Free and Fair Trade," the company claims to support "an open global system that benefits our consumers, employees, and the entire home appliance industry." The last-listed beneficiary betrays the real goal of the exercise. One cannot pursue the duel goals of free competition and anticompetitive privilege.

"Fair trade" is a clever way of saying that one does not want economic freedom. In this context, "fair" means only what the special interests say it does. Adding "fair" to "free trade" is like trying to mix oil and water.

The Office of the U.S. Trade Representative didn't use the term "free trade" anywhere in its press release, but it does speak of "fair and sustainable trade." The use of the term "sustainable" is fascinating for an administration that rejects the concept when it comes to the environment. It appears that any terminology that can advance a political agenda is worth using.

Whirlpool writes that its "community focus" is important because "the people who make our appliances are also the people who use our appliances." This is false of course. The people who make Whirlpool appliances are only a tiny fraction of those who use them. The company has 25,000 employees in the United States, of which less than 5% work in washer manufacturing (extrapolating from IBISWorld's numbers). But even using the 25,000 figure, those employees' households amount to less than 0.03% of U.S. households that have washing machines in the United States, and to about 0.01% of households that have Whirlpool-made ones.

COSTS AND BENEFITS

The tariff imposed on washing machines is a textbook case of why protectionism wins at the political game even if the winners gain much less than what others lose. Inversely, free trade benefits the vast majority of people much more than the disruption costs that some workers suffer from foreign competition.

On one hand, a tiny special interest group—a few thousand workers at most, plus a few executives and major shareholders—lobbies the U.S. government to protect their salaries and profits, which represent a significant benefit for each member of the group. Whirlpool's petition mentions that "safeguard relief would enable domestic producers to earn a return on their past investments." On the other hand, the cost is paid by 97 million households that will each suffer only a small loss. Which individuals in these two groups are more likely to engage in collective action—that is, pay lobbyists, participate in demonstrations, and such—to defend their interests?

Back-of-the-envelope calculations can serve to illustrate the answer. Assume the average washing machine costs $600 and has a functional life of 10 years. Its capital cost is thus about $60 per year. If a tariff increases the washing machine's price by 25%, a household will pay $150 more when buying a new one, or $15 a year.

Few individuals will engage in collective action to save $15 a year for their household. On the other side of the cost–benefit divide, a washer-manufacturing worker earns on average $47,876 a year (in 2016—estimate from IBISWorld). Each employee, perhaps prodded by his boss or peers, has a big incentive to support collective action. The Whirlpool petition includes the signatures of 2,464 employees at its Clyde plant. The lobbying incentive is even stronger for executives with salaries in the six, seven, or eight figures.

Now, consider total costs and total benefits. Multiplying the number of households by the annual cost of the tariff for each, we get a total cost of $1.4 billion a year. On the benefit side, multiplying the number of domestic manufacturing workers in washer manufacturing (assuming that half of the workers in the washer and dryer category are on the washer side) by the average salary given above produces an estimate of $57 million in combined earnings for manufacturing workers. If we add to this the profits realized in domestic washer manufacturing plus the salaries of related nonmanufacturing employees, the total of which can be estimated at about $224 million (most of which is corporate profit), we get a total of $281 million in benefits. These benefits of the new tariffs for domestic producers of washing machines amount to only one-fifth of the total cost of $1.4 billion to American consumers.

Note that these estimates grossly overstate the benefits of the new tariff. They assume that the whole domestic washer industry would otherwise disappear, that American shareholders would lose all the money invested in this segment of the appliance industry, and that all the employees would lose their jobs and be unable to find new ones elsewhere.

In fact, most of the workers would find new jobs. In a dynamic economy, jobs are continuously destroyed and replaced by new ones. A typical example: from March 2016 to March 2017, 12.9 million new private jobs were created and 10.9 million disappeared, for a net creation of 2 million jobs in 12 months.

Announcing the new tariffs, President Trump declared that this action will "demonstrate to the world that the United States will not be taken advantage of anymore." What he should have said is that American consumers *will* be taken advantage of. Aren't 97 million American households part of "the United States"?

A Whirlpool spokesman declared to the *Wall Street Journal* that the new protectionist measure was about "providing real benefits to consumers." This is either a cynical lie or a reflection of crass ignorance. As we repeatedly observe in this whole affair, it is difficult to defend protectionism without defective economics or flawed ethics.

FLAWED ETHICS AND OTHER DANGERS

Whirlpool likes to boast of its "social responsibility" (although I admit that, to its credit, it is not the most politically correct corporation in this regard). "We are proud to be recognized as one of the top U.S. companies for social responsibility," declared Whirlpool chairman Jeff Fettig in 2009 following the company's rating in the Boston College Center for Corporate Citizenship and Reputation Institute's Corporate Social Responsibility Index. A Whirlpool press release, apparently oblivious to the irony, stated that one of the criteria used by the index was "good feeling."

There is much good feeling to pass around. Whirlpool also boasts of giving out appliances to new homes for the poor, both in foreign countries and in America. The firm should instead manufacture washing machines competitive enough to not require forcing customs tariffs onto customers. It should stop lobbying the U.S. government to prevent poor foreign workers from selling goods that American consumers want to buy.

Doesn't the company's social responsibility dictate that it oppose forbidding American consumers to buy washing machines without paying a special tax when they choose an imported one? To repeat, protectionism hurts mainly the consumers of the country where it is imposed.

One may forgive Whirlpool for merely taking advantage of a vicious system and recognize that therein lies the weakness of a capitalist system under an interventionist state. But we may hope that the company, out of decency, would at least refrain from peddling gross untruths, incoherent pronouncements, shoddy economics, primitive morality, and hypocritical "social responsibility." Yet, the real solution would be to abolish the corrupt protectionist system.

The solar panel case is broadly similar to the washing machine case. One difference lies in the employment effect: since higher prices (generated by the tariff) for solar panels and modules will lead to fewer installations, and since many more jobs exist in installation (258,000 workers) than in manufacturing those solar units (2,000 workers), the net effect will be fewer jobs in the sector. Of course, consumer satisfaction, not producer security, should remain the criterion of public policy. Consumption, not labor per se, is what people want.

Protected by the new tariffs, domestic manufacturers of washing machines and solar panels will not be incited to become more competitive. They probably have no comparative advantage in these sectors anyway. Thus Whirlpool and solar panel manufacturers are likely to beg for new protectionist measures at the end of the tariff period. Moreover, the measures are already being challenged before the WTO, whose rules allow safeguards but under certain conditions. At any rate, the action signals a protectionist turn that could provoke foreign governments' retaliation against American exporters and could conceivably spark a trade war.

Whether foreign or domestic, competition always "injures" some competitors. But competition benefits consumers. This system is called free enterprise and economic freedom.

The negative effect of protectionism is harder for lower-income consumers, who spend more of their income on goods as opposed to less tradable services (or to savings). Ironically, the "deplorables" who elected Trump will be the first victims of the new American protectionism. *R*