



**OSBORNE PARTNERS**  
Capital Management, LLC

## **Are We In A Trade War?**

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Towards the end of the first quarter, the U.S. slapped tariffs on imported steel, aluminum, solar panels and washing machines. At first it was on all countries. Then several countries were exempted. China was not exempt and responded by putting tariffs on wine and pork. Then, the U.S. announced further tariffs on a variety of Chinese goods, and China responded in kind. Sounds like a trade war to me, but it just as easily could be “sound and fury signifying nothing.” Most of these tariffs have yet to be enacted, and this could well be a negotiating posture. But the actions and threats are unsettling to the markets and to the industries affected.

### **Tariffs in History**

In the U.S., tariffs were originally the main source of income for the fledgling government in the 1800s. This changed in 1914 with the advent of income tax. Since then, tariffs have been for the protection of U.S. goods and services. At the start of the depression in 1930, the famous Smoot-Hawley Tariff Act put tariffs on over 20,000 imported goods. Our trading partners retaliated. Subsequently, U.S. imports decreased 66% from \$4.4 billion (1929) to \$1.5 billion (1933), but exports also decreased 61% from \$5.4 billion to \$2.1 billion. GDP fell from \$103.1 billion in 1929 to \$75.8 billion in 1931 and bottomed out at \$55.6 billion in 1933. Imports from Europe decreased from a 1929 high of \$1.3 billion to just \$390 million during 1932, while U.S. exports to Europe decreased from \$2.3 billion in 1929 to \$784 million in 1932. World trade decreased by some 66% between 1929 and 1934. The tariffs proved to be a lose/lose situation.

The tariffs were not the cause of the depression. We now generally blame a weak banking system combined with deflating asset bubbles, but the tariffs made it worse. This has been the conventional wisdom since. So after WWII, barriers to trade were slowly eliminated worldwide. With some hiccups this has worked well for most all economies. There clearly was suffering and many victims in the process, but overall freer trade helped poorer countries escape poverty and richer countries have major improvements in their standards of living. Still, here in the U.S. we are no longer the biggest manufacturer in the world and have an enormous trade deficit that seems to always get larger. Taxing imports may reverse this trend by aiding some struggling industries and forcing other countries to open their borders, but this has not worked well in the past.

Free trade is based on the concept that one country produces a product that is better or cheaper than other countries, and that those countries likewise are better at producing other products. Cross border trade benefits both countries. The problems arise when one country wants to protect a less productive operation based on jobs or national pride. Since 1970, American-based manufacturing dominance has declined. This has been due to a variety of factors including post war growth in Asia and Europe, cheap labor in China and elsewhere, as well as trade deals that helped Mexico and Canada. It is no secret that much of our manufacturing has been outsourced overseas, and that China specifically has penalized American businesses



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from 25% tariffs on Teslas, to demands for technology transfers. In addition, and this is often overlooked, American companies set up factories overseas to sell to consumers in those countries.

**Will Tariffs Work Today?**

Right now we have a strong economy and most of the world is on a growth path; much different than the 1930s. There are no significant asset bubbles, except for possibly cryptocurrencies, and our banking rules, regulations and safeguards are much stronger. While businesses and economists overwhelmingly do not like the idea of a trade war, many Americans do, as witnessed by the upswing in our president's job approval ratings. Emotionally it appears that world growth has come at our expense, and barriers to world trade will help. It is called autarky. We can go it alone. Of course the result of taxing imports will be higher overall prices which most likely will temper this nationalistic enthusiasm. Trade wars reduce domestic growth, not enhance it.

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