Behind the Veil of Tariff Fixation

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The world needs a broader conception of trade policy that considers how economies allocate income

In the heated debates over trade policy in Washington and beyond, tariffs are often portrayed as the primary—or even the sole—instrument by which governments intervene in global commerce. They are easy to quantify, easier to politicize, and readily wielded in bilateral negotiations.

But this focus on tariffs is misleading. It obscures the more fundamental mechanisms by which countries shape their trade relationships with the world. Because a country's internal imbalances between consumption and production must always be consistent with its external imbalances, anything that affects the former must affect the latter, and vice versa. Tariffs are just one of many tools a government can use to change a country's internal imbalance.

Like most such tools, tariffs work by shifting income from consumers to producers. But because of their visibility, they are often among the most politically contentious of these tools. By contrast, many of the most powerful trade interventions in today's world occur not as tariffs but as policy choices that don't appear to be related to trade at all. Fiscal decisions, regulatory structures, labor policies, and institutional norms can all affect how income is distributed, and how economies are balanced between consumption and production, with far-reaching implications for global trade.

To understand why tariffs receive such disproportionate attention, it helps to consider their visibility. A tariff is a line item in a trade negotiation affecting the price of an imported good. It's easy to identify, easy to weaponize, easy to reverse, and very obviously linked to trade. But the very simplicity that makes a tariff politically salient also makes it a poor proxy for trade policy as a whole.

Income transfer

At its core, a tariff is a tax on imports. By making foreign goods more expensive, it gives domestic producers a pricing advantage. This can benefit certain industries and preserve jobs. But those benefits come at a cost: Consumers pay more for goods and services. The net effect is to transfer income from households to businesses, and it is this transfer that, by reducing the household share of GDP, reduces overall consumption relative to production.

This shifting of income from consumers to producers is the essence of trade intervention. Whether through a tariff, a tax subsidy, or a wage-suppressing labor law, the result is a change in the internal distribution of income that also has external implications. If consumption is taxed and production is subsidized, net exports are likely to rise. Conversely, if policies shift income from producers to consumers, net exports are likely to fall. In this sense, any policy that affects the balance between household consumption and total output will also

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affect the balance between domestic saving and domestic investment, and so is effectively a trade policy.

Consider currency policy. When a country intervenes in foreign exchange markets to keep its currency undervalued, it achieves the same goals as a tariff. A weaker currency makes imports more expensive and exports cheaper, subsidizing production and taxing consumption. Like tariffs, this represents a transfer of income from net importers (the household sector) to net exporters (the tradable goods sector), but it occurs through exchange rates rather than in the form of tariffs.

Financial repression can have the same effect. In countries in which the banking system serves mainly the supply side of the economy, suppressing interest rates is effectively a tax on the income of net savers (the household sector) and a credit subsidy for net borrowers (the producing sector). By transferring income from the former to the latter, it creates a domestic imbalance—just like the one created by tariffs or an undervalued currency—between consumption and production. This shows up in the form of higher net exports.

Strategic subsidies

Tax and regulatory policies can work similarly. Governments might provide direct or indirect subsidies to strategic industries, including by building infrastructure tailored to manufacturing clusters. These measures may not violate international rules on trade intervention, but they change relative incentives within the economy in ways that mirror traditional protectionism. By making it cheaper or more attractive to produce than to consume, they achieve the same end: an internal shift that produces an external effect.

Even labor market structures and social institutions can function as tools of trade intervention. In China, for example, the *hukou* system—a household registration system that limits rural migrants' rights in urban areas—has long served to depress wages and reduce household consumption. Although designed mainly to manage urbanization, the hukou system directly affects China's trade balance by limiting the growth of domestic demand relative to domestic supply.

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Similar effects can be seen in policies that encourage environmental degradation (by increasing business profitability at the expense of health care costs), restrict labor from organizing, hold down minimum wages, or reduce the bargaining power of workers. By suppressing wage growth and limiting consumption relative to productivity growth, these policies create the same kinds of imbalances as tariffs, but they do so far more quietly.

This broader perspective helps explain why some countries have run persistent trade surpluses even as they maintain relatively low tariffs. These economies have long emphasized production over consumption, whether through institutional structures, saving incentives, or export-oriented industrial policies. The result is the same: If domestic demand is too weak to absorb national output, these countries must externalize the cost of weak domestic demand by running trade surpluses.

The point is that trade imbalances are not just about what happens at the border. They are a consequence of how economies are structured internally—how income is distributed, how much households spend relative to what businesses produce, and how governments balance the competing demands of producers and consumers.

Implicit intervention

When governments pursue policies that favor investment over consumption, or capital over labor, they are engaging implicitly in trade intervention—whether they intend to or not. And as surplus countries implement domestic policies that prioritize producers over consumers, the deficit countries with which they trade are effectively prioritizing consumers over producers, whether they choose to or not.

A narrow focus on tariffs is misleading. It distracts from the underlying drivers of trade imbalances and invites counterproductive responses. As John Maynard Keynes argued at Bretton Woods in 1944, the fact that a diversified economy runs persistent trade surpluses is usually sufficient evidence of trade-distorting interventions. Whether or not these distortions are created by tariffs is largely irrelevant; in fact, to the extent that tariffs in deficit economies can force down trade imbalances, they may actually promote freer trade.

Rather than railing against tariffs, the world needs a broader conception of trade policy—one that moves beyond the surface-level debate over tariffs and looks inward at how economies allocate income. If trade imbalances are ultimately the result of internal choices about who gets what, then fixing them will require more than bilateral deals or protectionist gestures. It requires a change in how countries structure their economies. It requires power and resources to shift toward those whose spending drives sustainable demand. F&D

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