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COMMENTARY

Tariffs Won't Bring Back Manufacturing. What They Will Do to Stocks.

By David R. Breuhan

April 02, 2025, 11:06 am EDT

President Donald Trump calls the announcement of his new tariff policy "Liberation Day." (JIM WATSON / AFP / GETTY IMAGES)

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President Donald Trump promises a storm of new tariffs today. He says they are intended to return U.S. manufacturing to its lost glory. It is true that many of those jobs are gone, but the reasons for that change can't be fixed by tariffs.

Job losses in the U.S. started with President Richard Nixon's decision to remove the country from the gold exchange standard in 1971. Europeans began to worry about U.S. spending on the war in Vietnam and President Lyndon B. Johnson's sweeping "Great Society" domestic agenda. Demanding gold for dollars, Nixon closed the gold window. With an agreement from Saudi Arabia, the dollar became accepted for global oil payments. The "petrodollar" emerged and replaced gold as the world's reserve currency.

The dollar strengthened as other currencies weakened. This resulted in lower unit labor costs overseas. Manufacturing jobs began to leave the U.S., and the country became a net importer of merchandise. (The U.S. runs a capital surplus to balance this deficit, as money returns to the country when foreigners invest in our capital markets and other areas.)

Domestic factors also contributed to job losses. Over the next several decades, the U.S. business environment became much more hostile to entrepreneurs. Taxation, regulation, and litigation forced job creators to pivot, often monthly, from running a business to defending it. Rising crime also discouraged business. In many cases, firms left crime ridden areas. Environmental studies, rules, and activists often ground major projects, such as the Keystone XL pipeline, to a halt. Organized labor, while legal, sometimes dissuaded entrepreneurs from wanting to take the risk to start a new endeavor.

Many also blame China for the demise of the American worker. However, in many cases, corporate America willingly transferred their technology to China in order to access the market, allowing them to beat U.S. companies at their own game. Now, some U.S. firms demand tariffs against China to protect them from their own technology.

The Trump administration's weapon of choice to right these wrongs is tariffs. Its understanding is that foreign companies and governments will bear the cost of tariffs, resulting in massive revenues to the U.S. Treasury and reducing annual budget deficits. Foreign companies wishing to bypass the levies will be forced to open plants in the U.S. and produce their goods here.

But the administration fails to recognize several key truths about tariffs: Foreigners do not pay for them; the increased costs are passed directly to U.S. consumers; they cause retaliation by foreigners through retaliatory tariffs and boycotts against American exporting companies; and higher import costs and lower export sales result in lower profits and lower stock prices. This is already occurring, as markets discount future earnings.

To that first point: Tariffs are paid at the port of entry by U.S. companies to U.S. Customs and Border Protection. Those costs are then passed on to manufacturers and then to consumers. So tariffs behave as a type of price control, or an artificial price floor, that cause the price of a good to be much higher than it should be.

In that way, tariffs distort the pricing mechanism in the economy. Prices are meant to coordinate supply and demand, to allocate scarce resources to their most highly valued use. They are a guide to future production. In short, prices are a signal. Tariffs erode the quality of prices' information.

They may also spoil the long-standing global trade system between major powers that remained intact since the late 1940s, when Bretton Woods, the General Agreements on Tariffs and Trade, and NATO formed a framework for peace prosperity as Western civilization emerged from the ashes of World War II. This postwar system felled political barriers and increased technology and trade—which in turn increased resource mobility and decreased transaction costs. Capitalism flourished. Freedom spread in Eastern Europe after the fall of communism. The U.S. led in innovation.

As its leader, the U.S. became the primary beneficiary of this system. Currently, U.S. gross domestic product makes up roughly a fourth of global GDP. Foreign investment, which ties our trading partners' future to ours, is high. Although we run a merchandise trade imbalance with Canada of $63 billion, they own $350 billion in U.S. Treasuries. Foreigners own $8.5 trillion of our $36.2 trillion debt.

We are doing this while making up only 4% of the world's population. We are punching far above our weight class.

Yet Trump repeatedly claims "the world has taken advantage" of the U.S., and evidences the decline in manufacturing jobs.

Trump often cites Republican President William McKinley as an example of how tariffs made America prosperous at the turn of the 20th century. He ignores the importance of the industrial revolution, the widespread adoption of electric lighting, and the return to the gold standard by the U.S. in 1879, which fostered sound money, to this boom.

Trump should study the trade policy of another Republican president, Herbert Hoover, and the Smoot-Hawley Tariff of 1930. Hoover's protectionist policies resulted in the Great Depression, which produced the economic nationalism in Europe that significantly contributed to the Second World War.

The old adage is true: "When goods don't cross borders, armies will."

Dismantle the global trading system at your own risk.

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