Trump's Tariffs & Dynamic Models

by Earl P. Holt III

The discipline of economics has been plagued for decades by a reliance on what are often called ***"static models,"*** instead of ***"dynamic models"*** that more accurately reflect the *real world.* This blinded many economists to the virtues of dynamic, *"supply-side economics"* during the Reagan and first Trump Administrations. It was also at the heart of the heated debate over tariffs that took place between Donald Trump and his ***Bloomberg News*** interrogator at the ***Economic Club of Chicago*** on October 15th.

Trump & the *Bloomberg News Editor-in-Chief*

Here's a simple illustration of the difference between static and dynamic models in a different context: If a nation reduces its income tax rates by 50 percent, *static* modelling predicts that tax revenues will decline by 50 percent as a consequence. **Those who are blind to *dynamic* models are content to accept this simple-minded prediction.** But, as we've learned

several times in prior decades, reducing a nation's tax burden often unleashes unanticipated economic activity, eventually ***INCREASING*** tax revenues rather than reducing them. This is merely an application of ***The Law of Diminishing Marginal Returns from Taxation.***

This concept is not nearly as complicated as it sounds, and even individuals who have never studied economics before often intuitively recognize and practice its defining principle. For example, those of us who consume adult beverages recognize that the first beer tastes exceptionally good, the second about as good, but the 12th beer inevitably creates unanticipated costs, such as awakening with a hangover in a county *drunk-tank* or getting arrested for a DUI. (Hence, *diminishing marginal returns* from drinking beer.)

Greater tax revenues at *lower* rates followed JFK's ***Tax Reduction Act*** of 1963, as well as the ***1978 Steiger Amendment*** that reduced the Capital Gains Tax. Its most dramatic demonstration came as a result of President Reagan's ***Economic Recovery Tax Act of 1981,*** where lowered tax rates did ***NOT*** produce *lower* tax revenues, it ***DOUBLED* THEM!** In the 1980 Fiscal Year prior to Reagan taking office, Treasury Revenues were **$517.1 Billion**. After his significant tax cuts, when Reagan left office in 1989, Treasury Revenues were **$991.1 Billion**, an increase of 92 percent. **(NOTE: *These figures seem small compared to current spending levels because inflation has left the U.$. Dollar at a fraction of it's 1980 value, while "Uni-Party" spending levels have skyrocketed.*)**

NOW, BACK TO Trump's Tariffs: The dispute over tariffs between Trump and ***Bloomberg*** Editor-in-Chief, John Micklethwait, stems from Trump thinking dynamically, while Micklethwait is thinking statically. Using the same, tired *static* model that has mis-led U.S. trade policy for decades, Micklethwait predicted that Trump's proposed tariffs on imported goods would dramatically reduce U.S. *Gross National Product* (GNP.) He suggested it would harm everyone whose job depends on handling,

transporting and selling imported goods, particularly high-end manufactured goods. If I remember correctly, he predicted that Trump's tariffs would reduce U.S. GNP by 27 percent.

Much like those who sneer at supply-side economics, Micklethwait is content to predict huge declines in U.S. GNP from Trump's tariffs and leave it at that. However, Trump is versed in the dynamic processes of *REAL WORLD* capitalism, in contrast to the static models used by those who merely write about it rather than experience it directly, and for whom the economy is a mere abstraction. To Trump, tariffs are a *"multifaceted tool*" that can set-in-motion many beneficial but unanticipated responses on the part of trading partners, above and beyond the revenues they generate.

For example, many foreign auto-makers may very well be motivated to **move their plants to the U.S.** to avoid Trump's tariffs on their exported products. Trump made this point to Micklethwait regarding German and Japanese auto manufacturers, who have enthusiastically exploited U.S. markets for years, while stubbornly denying their own markets to U.S. auto-makers. They may also eliminate their tariffs on U.S. goods.

Devious trading partners like China and the European Union may be motivated to lower or **remove their own tariffs** that are currently imposed on U.S. manufactured goods, as a reaction to Trump tariffs. Neither is currently practicing the *"reciprocal"* trade that is demanded of nations belonging to the ***World Trade Organization***, or which have been granted *Most Favored Nation* trading status with the U.S.

Likewise, foreign competitors that move manufacturing plants to the U.S. will definitely improve the prospect for high-paying manufacturing jobs here. This will mean more Americans will have the opportunity to support themselves and their families with a ***living wage***, rather than sit on their asses and draw unemployment or welfare. Additional taxpayers

added to the tax rolls would be another source of **tax revenues** to the Treasury. Mickelthwait's model anticipates none of these phenomena.

Mickelthwait also warned that Trump's plan to impose tariffs on hostile trading partners will produce a *"trade war"* within global markets. Trump correctly recognizes that we are ***ALREADY IN A TRADE WAR,*** although our political leadership has chosen to ignore it because it exposes their own incompetence and betrayal. Tariffs are merely one technique for levelling the playing field against those who embargo U.S. products and refuse to engage in **RECIPROCAL TRADE**.

Trump deserves a great deal of credit for rejecting the abstract and static models that are routinely taught in business schools and economics courses. The German sociologist Max Weber was renowned for his pioneering work that distinguished between ***Theory and Practice,*** and this dichotomy is clearly familiar to Donald Trump. That's why Trump is correct about the need to apply tariffs, and his critics are mistaken.