## President's Message

# Trade and Trepidation

If a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry, employed in a way in which we have some advantage." Since Adam Smith wrote those words in 1776, it has become an enduring consensus among economists that trade makes us all better off by giving consumers and businesses access to more and cheaper goods, and by spurring new efficiencies and innovations.

That doesn't mean there aren't costs. Recent research suggests it can take a decade or more for a local labor market to adjust to the job loss that results from foreign competition. In our district, many communities have been disrupted by the loss of furniture, textile, and steel manufacturing. In the long run, these disruptions may be outweighed by the benefits of trade, but in the short run, figuring out how best to support the people and communities that bear the costs is an important objective for policymakers.

Policymakers sometimes try to curb foreign competition in the first place via trade restrictions such as tariffs or quotas. Regulating trade is far outside the Fed's purview, so it's not our place to weigh in on the pros or cons of any particular policy. But economic theory tells us that restricting trade has a number of potential downsides.

One possible harm is that consumers pay higher prices, either because there isn't a domestic substitute for the foreign good or because the higher price for foreign goods enables domestic producers to raise their prices as well. In addition, U.S. producers import a large share of their intermediate inputs; if those inputs get more expensive, firms might have to raise their prices to recover their costs. We might also see negative economic effects if other countries impose their own trade restrictions to retaliate. That could make U.S. exports less desirable, leading to an oversupply of, and lower prices for, the affected goods. The resulting lower profits for these manufacturers could put jobs at risk.

It's not all downside; for example, firms in the industries being protected may create more jobs, as several metal manufacturers recently have announced they will do. But economic theory suggests those job gains could be offset by job losses in other sectors.

The current trade disputes put several industries in the Fifth District at risk, as Tim Sablik discusses in "Tariffs and Trade Disputes" in this issue. (See page 10.) Car manufacturers in South Carolina, soybean farmers in Virginia, and pork producers and tobacco farmers in North Carolina are all facing new tariffs on their products in China. Maryland and West Virginia are both large importers of steel and aluminum; tariffs could increase costs for manufacturers in these states.

Of course, we don't know precisely what the effects of these tariffs will be. Supply chains have grown increasingly complex, which makes it difficult to predict how changing prices and costs will be dispersed. And if firms expect the tariffs to be temporary, then they might be less likely to significantly alter their prices or production processes.

But one area where I believe we are seeing a clear impact is confidence. For the most part, people feel pretty good about the economy. The University of Michigan's Survey of Consumer Sentiment is back to pre-Great Recession levels, and the Conference Board's measure of consumer confidence is actually higher than it was in the mid-2000s. At the same time, people are increasingly worried about the future with regard to trade. The share of households in the Michigan survey who spontaneously mentioned trade as a concern has more than doubled since May, from 15 percent to 35 percent, and the Conference Board's surveys document a widening gap between people's confidence about the present and their expectations for the future.

Similar results are obtained from surveys of CEOs and business owners. While many firms continue to project high levels of hiring and investment, those projections have fallen in recent months, and 95 percent of CEOs surveyed by the Business Roundtable were concerned about the effects of tariffs on U.S. exports.

It's certainly a concern I've heard from our business contacts throughout the Fifth District. And I'm not alone; in July's Beige Book, a compilation of regional data from each of the 12 Federal Reserve districts, every single Reserve Bank specifically mentioned trade policy as a source of concern or uncertainty for businesses in their district.

Uncertainty is bad for business. So in addition to the effects on sales and prices, the extent to which trade policy affects confidence is something I'll be watching very closely. **EF**

**TOM BARKIN**
**PRESIDENT**
**FEDERAL RESERVE BANK OF RICHMOND**