

The top portion of the cover features the flag of the People's Republic of China, with a red field and five golden-yellow stars in the canton.

The Effects of Crony Capitalism— Alias: Government Intervention

A row of seven black tires with a tread pattern, stacked horizontally across the middle of the cover. The tires are set against a background that transitions from the Chinese flag at the top to the American flag at the bottom.

**A review of the 2009 United States trade tariff
on Chinese tires**

Chance Fuller

Free market capitalism in its truest form is the freedom to allow market forces to shape the economic world we live in. Unfortunately, although freedom is a clear and simple ideal, true free market capitalism is often compromised and is quite hard to come by. Crony capitalism is a suboptimal version of capitalism because it is infected with restrictions put in place by the government and/or other biased parties. One example of crony capitalism is the 2009 United States (US) trade tariff on Chinese tires. This paper explores the negative impacts associated with the implementation of this tariff. Although the negative impacts were far reaching and numerous, the focus will be on lower domestic employment, decreased corporate profits, and increased cost of living.

The Chinese tire tariff

In 2008, China's supply of tires to the United States began to disrupt the domestic economy (Hill, 2013). In response to this disruption and the associated public outcry, the US government placed a substantial tariff on Chinese tires in September 2009 (Hufbauer, 2012). As with most crony capitalist situations, the US trade tariff on Chinese tires had good intentions and was originally put in place to protect US jobs. President Barack Obama is on the record as saying that the trade tariff on Chinese tires was meant to increase US jobs. In his State of the Union Address on January 24, 2012, President Obama stated "we've brought trade cases against China at nearly twice the rate as the last administration—and it's made a difference. Over a thousand Americans are working today because we stopped a surge in

Chinese tires” (Rapoza, 2012). Unfortunately, these benefits were not actually realized. In reality, substantial negative consequences ensued.

Employment statistics

One impact of the US tariff on Chinese tires was a decline in US tire industry jobs. The US tire industry has struggled with job growth for a number of years and despite expectations to the contrary, the 2009 tire tariff did not help. According to the US Bureau of Labor Statistics, in 2009 there were approximately 55,000 jobs in the US tire industry. As of 2011, that number declined to 51,700 jobs (Rapoza, 2012). It is possible that this decline could have been worse had the tariffs not been put in place, but the tariff most definitely did not create additional jobs. Clearly the government’s intervention, the crony capitalism, did not help taxpayers get jobs. Instead, it created an artificial supply and demand relationship causing uncertainty in the labour market.



One impact of the US tariff on Chinese tires was a decline in US tire industry jobs



Bigstock

Corporate profits

Another negative component of the US tariff on Chinese tires was its inability to protect corporate profits for US tire manufacturers. One would expect the US tire companies to experience increased profits due to the tariffs. After all, the companies should have had lower employment costs due to a decreased number of jobs and an increased demand for their tires due to the decreased tire supply available from China. Unfortunately, this was also not the case.

Chinese tire imports to the US did decrease by 30% from 2009 to 2011. But there was an

unexpected consequence: the decrease in Chinese supply was not filled by tires from US manufacturers. Instead, the supply gap was filled with tires from other foreign competitors. Tire imports from other countries increased dramatically. For instance, imports from Canada increased by 30%, imports from South Korea increased by 110%, and imports from Indonesia increased by 152% (Rapoza, 2012). Thinking through this chain of events, one can see how altering the freedom associated with free market capitalism once again failed to help everyone involved. Workers in the US lost jobs, jobs were artificially created in other countries, and Chinese corporations and employees lost profits that would have rightfully been theirs in a truly free global market system.



Bigstock

Cost of living

In addition to the unfortunate impacts noted above, the US tariff on Chinese tires also resulted in a cost of living increase for US citizens. This increase came in the form of both direct costs through higher priced tires and indirect costs as a result of China's retaliatory implementation of a chicken tariff.

Direct cost— increasing tire prices

The tire tariff increased the cost of living for US consumers because lower cost tires were not available. Taxpayers were forced to buy more expensive tires from producers that were not hampered by the Chinese tire tariff. According to Gary Hufbauer and Sean Lowry of the Peterson Institute of International Economics, the cost to taxpayers as a result of the US trade tariffs on Chinese tires was in excess of \$1 billion. Clearly this is not a win for the US consumer. In addition to hurting the US consumer, there were likely lost wages and lost profits in China, and potentially in other countries, as a result of the distorted supply-and-demand relationship that was created. Thus the US

The tire tariff increased the cost of living for US consumers

government's crony capitalism caused a \$1 billion ripple effect that cascaded throughout the world.

Retaliatory cost—loss of domestic exports

Finally, the US economy lost another estimated \$1 billion as China reacted to the tire tariff with a retaliatory tariff on chickens. On February 5, 2010, China's Ministry of Commerce placed a trade tariff on chicken products imported from the US and other countries (Hufbauer, 2012). US chicken producers were forced to reduce chicken exports to China by 90%. Once again, the US economy was hurt by the government's choice to intervene and restrict the global free market system.

Summary

Crony capitalism is a disease. Its symptoms are a loss of freedom and a restriction of free market forces. Often the restrictions and actions of crony capitalism are put in place with well meaning goals, but invariably they fail to fulfill those goals. In the case of the trade tariff on Chinese tires, corporations lost revenue and taxpayers lost both jobs and money. Perhaps most interesting in this particular case is the fact that global freedom was restricted by the ruling authority in the "land of the free." The US government communicated that its actions would save US jobs and would therefore serve the nation well. Unfortunately, this was not the case and hopefully the experience will serve as a

reminder that, as Larry Kudlow has said, “free market capitalism is the best path to prosperity.”

References

Hill, Charles, W.L. (2013). *The Political Economy of International Trade. International Business: Competing in the Global Marketplace*. 9E ed. McGraw-Hill Irwin.

Hufbauer, Gary C., and Sean Lowry (2012). *US Tire Tariffs: Saving Few*. Policy Brief B12–9 (April). Peterson Institute for International Economics. <<http://www.iie.com/publications/pb/pb12-9.pdf>>, as of November 28, 2014.

Rapoza, Kenneth (2014, Jan. 25). Obama’s Half-Truth on China Tire Tariffs. *Forbes*. <<http://www.forbes.com/sites/kenrapoza/2012/01/25/obamas-half-truth-on-china-tire-tariffs/>>, as of May 18, 2014.

Shedlock, Mike (2010, Feb. 7). China Announces 105% Tariffs on Chickens in Retaliation for US Steel and Tire Tariffs. *Mish’s Global Economic Trend Analysis*. <<http://globaleconomicanalysis.blogspot.com/2010/02/china-announces-105-tariffs-on-chickens.html>>, as of May 18, 2014.



Chance Fuller was enrolled in the University of Alberta MBA program prior to his enrollment at Harvard Business School.

The Fraser Institute Essay Contest is generously sponsored by the Lotte & John Hecht Memorial Foundation.