BOFIT blog

Who'll pay Trump's tariffs?

International economy | 11 November 2024 | Sanna Kurronen

AUTHOR



Sanna Kurronen
Senior Economist

Incoming American president Donald Trump campaigned on a promise to impose additional tariffs on US imports as a way to reduce the country's current account deficit and boost domestic production. Initially, the proposal was for a 10% tariff, but later Trump has talked about a 20% tariff. In addition, tariffs on China would be at least 60%. Who eats the costs of such tariffs?



Incoming American president Donald Trump campaigned on a promise to impose additional tariffs on US imports as a way to reduce the country's current account deficit and boost domestic production. Initially, the proposal was for a 10% tariff, but later Trump has talked about a 20% tariff. In addition, tariffs on China would be at least 60%. Who eats the costs of such tariffs?

In September, Warwick McKibben, Megan Hogan and Marcus Noland at the Peterson Institute for

International Economics (PIIE) posted a working paper modelling the potential impacts of additional tariffs on the economy in the US and its main trading partners (McKibbin et al., 2024). The analysis considers the impacts of a general 10 % tariff through 2028 that results in a cumulative GDP decline of just over one percentage point in the US compared to the baseline. That impact more than doubles, however, when US trading partners respond with retaliatory tariffs. The price level in the US in 2028 is almost 1 % above baseline due to the additional tariffs imposed, and nearly 2 % above baseline if trading partners implement countermeasures. The authors estimate that the application of a blanket 10 % tariff by the US cumulatively reduces German GDP in 2028 by a few tenths of a percentage point from the baseline scenario. The effect is somewhat larger if Europe responds with retaliatory tariffs, but the impact on German inflation is still modest in either case.

Some of the impacts of higher tariffs would likely be offset by a stronger dollar, a reflection of lower US imports and the resulting decrease in demand for the currencies of major trading partners. The analysis with 10 % additional tariffs roughly leads to a 5 % appreciation in the dollar's exchange rate.

American businesses and households paid for Trump's previous tariffs

Studies of the 2018–2019 tariff war between the US and China support the findings of the PIIE paper. Oliver Jeanne and Jeongwon Son (2024), for example, perform high-frequency news analysis to assess the extent to which the effects of tariffs might be offset by changes in exchange rates. In the case of the additional tariffs placed on China by the US in 2018–2019, their analysis suggest that US tariffs accounted for as much as two-thirds of yuan depreciation in that period, while tariff news only explain about a fifth of dollar appreciation. Makram Khalil and Felix Strobel (2024) argue that trade policy uncertainty in itself is sufficient to drive dollar appreciation and partly deny the otherwise improved competitiveness the US seeks from imposing tariffs.

Another paper (Cavallo et al., 2021), which uses at-border and retailer microdata to tease out pass-through effects on imports subject to the 2018–2019 additional tariffs, finds that most of the tariffs were passed along. Chinese exporters made essentially no dollar price concessions despite the yuan's depreciation, meaning that the costs of tariffs were largely borne by American firms in the form of reduced profit margins or by households in higher retail prices. The study of Amiti et al. (2019) finds similar evidence that the entire cost of tariffs was passed through to American firms and households.

American producers also carried a large part of the costs from retaliatory tariffs (Cavallo et al., 2021). The authors note that Chinese products subject to tariffs tend to be specialised, which makes it difficult to find adequate substitutes. Retaliatory tariffs on the other hand largely focus

on agricultural commodities that can be sourced from other countries, forcing the domestic US producer to carry much of the burden from retaliatory tariffs.

Ultimately, the impacts of additional tariffs will depend on how well US producers come up with substitutes to the affected import goods. Given that the US labour force is already at or near full employment and Trump's threats to deport immigrants or otherwise restrict immigration, adequate substitutes for imported goods are likely to be scarce over the short term. American firms and households will likely bear most of the costs from a new round of tariffs, and doing nothing presently seems the least costly response for US trading partners dealing with the impending tariff drama.

References

McKibbin, W., Hogan, M. ja Noland, M. (2024). The international economic implications of a second Trump presidency, PIIE.

Amiti, M., Redding, S. J. ja Weinstein D. E. (2019). "The Impact of the 2018 Tariffs on Prices and Welfare." Journal of Economic Perspectives, 33 (4): 187–210.

Cavallo, A., Gopinath, G., Neiman, B. ja Tang, J. (2021). "Tariff Pass-Through at the Border and at the Store: Evidence from US Trade Policy." American Economic Review: Insights, 3 (1): 19–34. https://www.aeaweb.org/articles?id=10.1257/aeri.20190536

Jeanne, O. ja Son J. (2024). To what extent are tariffs offset by exchange rates?,Journal of International Money and Finance, Volume 142. https://www.sciencedirect.com/science/article/pii/S0261560624000020

Khalil, M. ja Strobel, F. (2024). US trade policy and the US dollar, Journal of In-ternational Economics, Volume 151. https://www.sciencedirect.com/science/article/pii/S0022199624000977

Keywords

, China, trade war, USA