SeaHawk Tutors

A-Level Economics - Topical Stories   February 2024

Trump’s Proposed New Tariffs

In the news 2024

Background

Donald Trump is the front-runner for the Republican nomination for the presidential elections in November 2024. Polls show that there is every chance that he could win the presidency back.

In his previous administration, he leaned towards a more protectionist set of economic policies, under the heading of ‘America First,’ than most of his recent predecessors.

Recent news stories suggest that, if he wins the presidency, he will push for a very significant increase in tariffs on imported goods.

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https://www.washingtonpost.com/business/2024/01/27/trump-china-trade-war/

https://www.forbes.com/sites/taxnotes/2024/02/12/its-2024-and-trumps-tariffs-are-still-a-bad-idea/

https://en.wikipedia.org/wiki/Tariff_of_1789

https://en.wikipedia.org/wiki/Trump_tariffs

Topic relevance

International Trade

- Protectionism
- Tariffs and trade

Direct and Indirect Taxes

- Regressive taxation

Business objectives

- Behaviour of firms

Economic principles

- Law of unintended consequences

Sample questions:

Extract 1: Forbes Feb 12 2024 (adpated)

A recent story in The Washington Post *claims that Trump and his advisors are contemplating a three-pronged tariff strategy, should he prevail in the November elections. According to these reports, the first step would be an across-the-board tariff of 10 percent applied to almost all goods entering the country. This batch of tariffs would come to represent the “price of admission” when foreign manufacturers seek access to the U.S. market, the largest consumer market in the world.*

Second, Trump would call for an additional tariff of 60 percent applied to goods from China. Unlike the first batch, these tariffs would be punitive in nature. Their purpose is to punish China for various economic and commercial grievances. Trump already increased tariffs on Chinese goods (from roughly 3 percent to 12 percent) during his first administration. Bumping the rate up to 60 percent might be the single largest tariff increase in modern U.S. history.

An increase of that magnitude would surely trigger a swift and equivalent countermeasure from China that would slam doors shut for U.S. exporters.

Third, Trump would impose a series of targeted tariffs that correspond to the “special taxes” other countries impose on U.S. goods as they enter their markets.

Who Pays Tariffs?

U.S. tariffs are directly paid by the U.S. importer. The question is what happens next. No importer wants to soak up a tariff, which cuts into the profit margin — perhaps eliminating it altogether. Neither do the wholesalers or distributors who feature in the domestic supply chain. To the extent they can, each of these firms will pass the additional charge on to the next person, until it eventually rests with the final consumer. That’s not necessarily a retail consumer. A significant share of U.S. imports are business inputs, for which the effect of a tariff is to increase production costs.

It’s often assumed that something less than 100 percent of a tariff is passed on to domestic consumers. The thinking is that, following the introduction of a tariff, foreign manufacturers will adjust their prices downward to prevent their goods from being uncompetitively priced, and not selling at all. To the extent that occurs, it means the foreign producer is absorbing some portion of the tariff burden. It’s difficult to reach generalized conclusions about how frequently that occurs. The competitive circumstances of each import transaction differ because of the nuances of supply and demand.

The picture that emerges from economic research is not encouraging for proponents of higher tariffs. One study focused on the effects of first round of Trump tariffs imposed between 2018 and 2019 on a narrow range of products (solar panels, aluminum, steel, and washing machines). They found that the entire burden of the tariffs landed on U.S. businesses and consumers, causing them to incur $114 billion in losses.

Other researchers arrived at similar conclusions, with the details of price responsiveness varying by product type. One study found that retail prices for handbags rose more quickly following the introduction of tariffs than the prices for bicycles and refrigerators. The rate at which tariffs are passed through to consumers can change over time. One study of U.S. steel imports found a passthrough rate of 100 percent during the first year a tariff was in force, with the rate declining in the second year of the tariffs. The data paints a picture in which, upon the introduction of a tariff, U.S. businesses are quick to adjust their pricing while foreign exporters are remarkably slow to adjust theirs.

It's hard to say with ironclad precision what the tariff passthrough rate has been over the last few years. It's not 100 percent, though it may well be close to it. So, yes, it is literally true that foreign manufacturers don't benefit from U.S. tariffs — but that's a far cry from saying they pay them. The evidence is clear that U.S. consumers predominantly bear the burden.

One study noted the occurrence of over-shifting, which occurs when U.S. business increase their prices by more than the amount of the tariff. For example, the authors of the study found that a $1 increase in the U.S. tariff applied to imported solar panels resulted in a $1.34 increase in retail prices. That suggests U.S. firms were adjusting prices not merely to preserve their pre-tariff margins, but to expand them. This raises the possibility that U.S. tariffs are partly responsible for recent inflationary pressure.

Over-shifting exhibits a crossover effect that can reach complementary product lines. For instance, it was observed that U.S. tariffs applied to imported washing machines not only caused an upward movement in retail prices ($86 per unit), but also triggered an increase ($92 per unit) in the retail prices of dryers — although imported dryers were not subject to any new tariffs at the time.

Let's not forget that an aggressive tariff policy can harm the U.S. economy in ways that don't show up in retail prices. During the Trump administration, Congress approved a $30 billion bailout for the U.S. agricultural sector to compensate farmers for the sharp decline in business they suffered when China enacted its own tariffs in response to U.S. tariffs. You know that an economic policy is bad when it requires a $30 billion rescue package to make up for the economic harm it inflicted on an important domestic constituency. How big will the next bailout be if U.S. exporters are shut out of China altogether?

Extract 2: The 2018 Trump Tariffs - Wikipedia (adapted)

*The **Trump tariffs** are a series of United States tariffs imposed during the presidency of Donald Trump as part of his "America First" economic policy to reduce the United States trade deficit by shifting American trade policy from multilateral free trade agreements to bilateral trade deals. In January 2018, Trump imposed tariffs on solar panels and washing machines of 30 to 50 percent. In March 2018, he imposed tariffs on steel (25%) and aluminum (10%) from most countries, which, according to Morgan Stanley, covered an estimated 4.1 percent of U.S. imports. In June 2018, this was extended to the European Union, Canada, and Mexico. The Trump administration separately set and escalated tariffs on goods imported from China, leading to a trade war.*

The tariffs angered trading partners, who implemented retaliatory tariffs on U.S. goods. In June 2018, India planned to recoup trade penalties of $241 million on $1.2 billion worth of Indian steel and aluminum, but attempted talks delayed these until June 2019 when India imposed retaliatory tariffs on $240 million worth of U.S. goods. Canada imposed matching retaliatory tariffs on July 1, 2018. China implemented retaliatory tariffs equivalent to the $34 billion tariff imposed on it by the U.S. In July 2018, the Trump administration announced it would use a Great Depression-era program, the Commodity Credit Corporation (CCC), to pay farmers up to $12 billion, increasing the aid to $28 billion in May 2019. The USDA estimated that aid payments constituted more one than one-third of total farm income in 2019 and 2020.

Tariff negotiations in North America were relatively more successful, with the U.S. lifting the steel and aluminum tariffs on Canada and Mexico on May 20, 2019, joining Australia and Argentina in being the only nations exempted from the regulations.

A May 2019 analysis conducted by CNBC found Trump's tariffs are equivalent to one of the largest tax increases in the U.S. in decades. Studies have found that Trump's tariffs reduced real income in the United States, as well as adversely affecting U.S. GDP. Some studies also concluded that the tariffs adversely affected Republican candidates in elections

1. **Examine how importers of raw materials on which new tariffs have been imposed may adjust the prices of their finished goods, and the associated impact on their profits. [8]**

2. **Discuss the intended and actual economic effects of tariffs on imported goods. [12]**

3. **The first major piece of legislation passed by the newly-formed United States Congress was the 1789 Tariff Act, levying a 50 cent per ton duty on all goods that were imported on foreign ships. Its dual purposes were (1) to raise funds for the new government and (2) to protect fledgling US industry. Discuss the effectiveness of tariffs as economic policy tools. [25]**