What to make of Trump's tariffs

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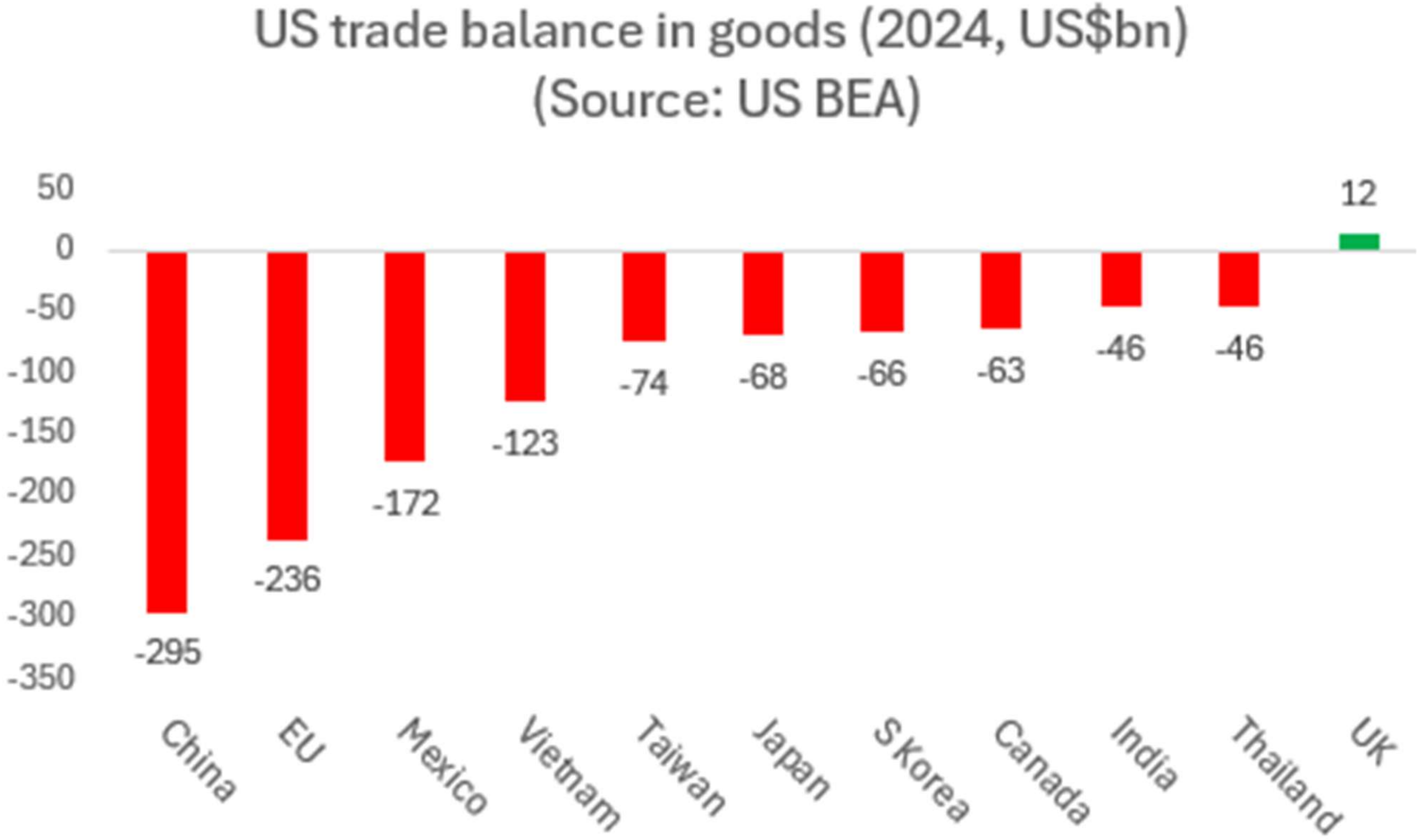
1. 'Trumponomics'

1. Increase tariffs on imports to reduce trade imbalances, bring jobs home, and raise revenues
2. Extend existing tax cuts and make some new ones
3. Reduce the size and role of the state by deregulation and by cutting Federal spending

2. The US runs large deficits in trade in goods



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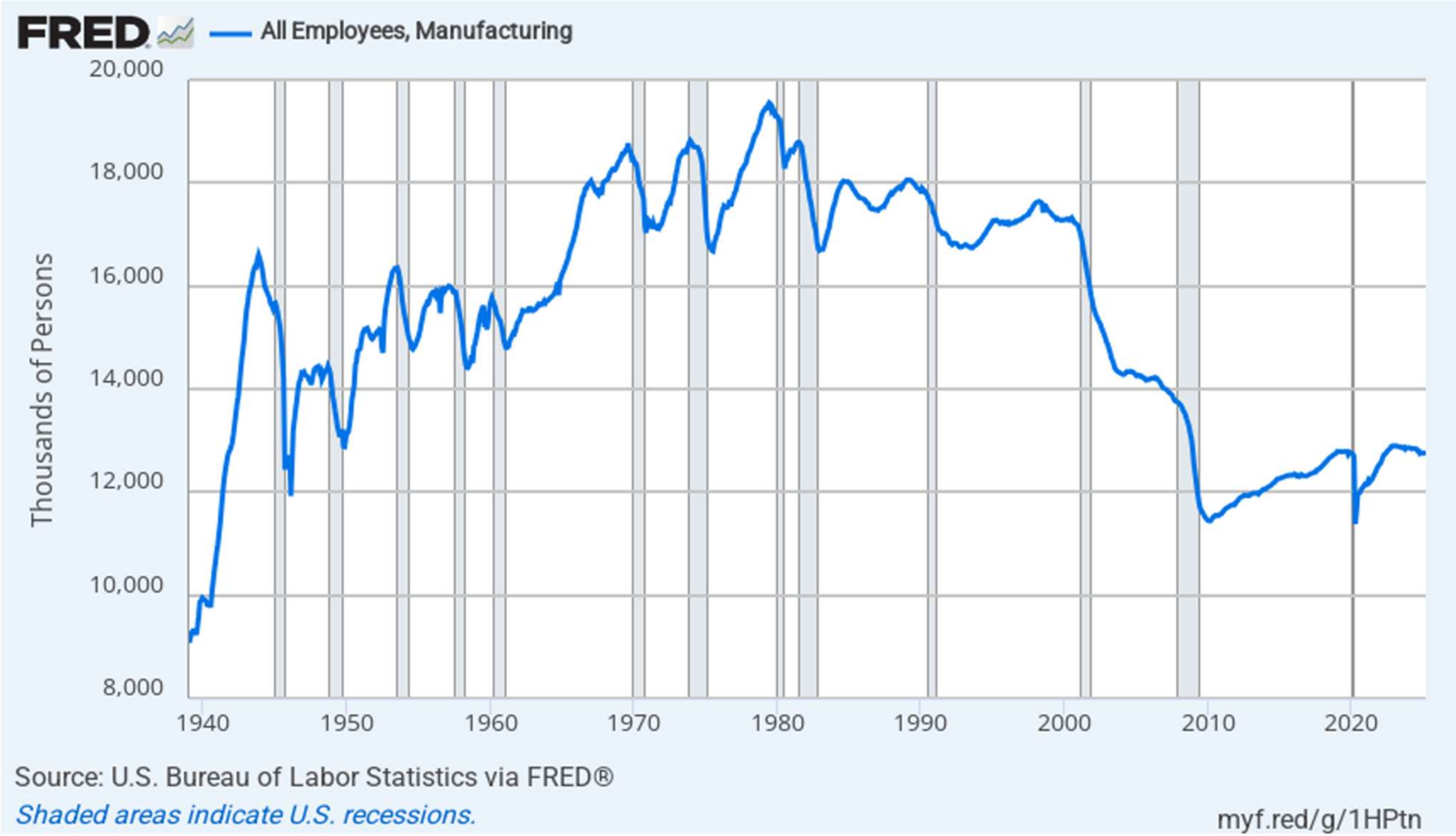
3. “More than 6 million manufacturing jobs lost”



4. The state of play on tariffs

- The US now has a bewildering array of different tariffs for different countries and for different goods:

  1. sector-specific tariffs, notably 25% on cars and steel
  2. punitive tariffs on China, some as high as 145%
  3. ‘reciprocal tariffs’ on almost everyone else
  4. a wide range of discounts and exemptions, notably on pharmaceuticals, fuels, and some electronic goods (even from China), which may or not be temporary…

- The average effective US tariff on imports from the rest of the world has risen from around 3% to more than 20% (higher than in the Smoot–Hawley Act of 1930…)

5. What are 'reciprocal tariffs'?

- On 2 April Trump announced new general tariffs on imports from almost all countries
- These were set at half the rate judged necessary to balance bilateral trade in goods with each one
- Where the US runs a surplus (including the UK), a baseline tariff of 10% would apply
- Where the US runs a deficit, a higher tariff applies
- The higher rates have since been suspended for 90 days, but the baseline 10% is still in place

6. How reciprocal tariffs are calculated

(sound maths, but bad economics)

$$\Delta\tau_i = \frac{x_i - m_i}{\varepsilon * \varphi * m_i}.$$

τ = tariff rate on country i

x = exports to country i

m = imports from country i

ε = price elasticity of import demand (set at 4 – too high)

ϕ = pass-through from tariffs to import prices (0.25 – too low)

7. What's the thinking behind these tariffs?

- Trump believes that an imbalance in trade in goods must be due to cheating by the surplus country
- Artificial trade barriers could include:

  1. tariffs on imports
  2. other taxes that discriminate against US firms
  3. non-tariff barriers, such as product standards
  4. currency manipulation
  5. export subsidies
  6. 'dumping' goods at below cost

8. Does this make any sense?

- The US has some legitimate concerns about trade distortions, but has made no attempt to target them
- Instead, the US has assumed that trade barriers can be proxied by the size of the deficit (in goods only)
- There is no world in which you would expect each country to have balanced bilateral trade with each and every other country
- For example, country A might run a deficit with B offset by a surplus with C, depending on what each country does best (based on 'comparative advantage')

9. A simple analogy

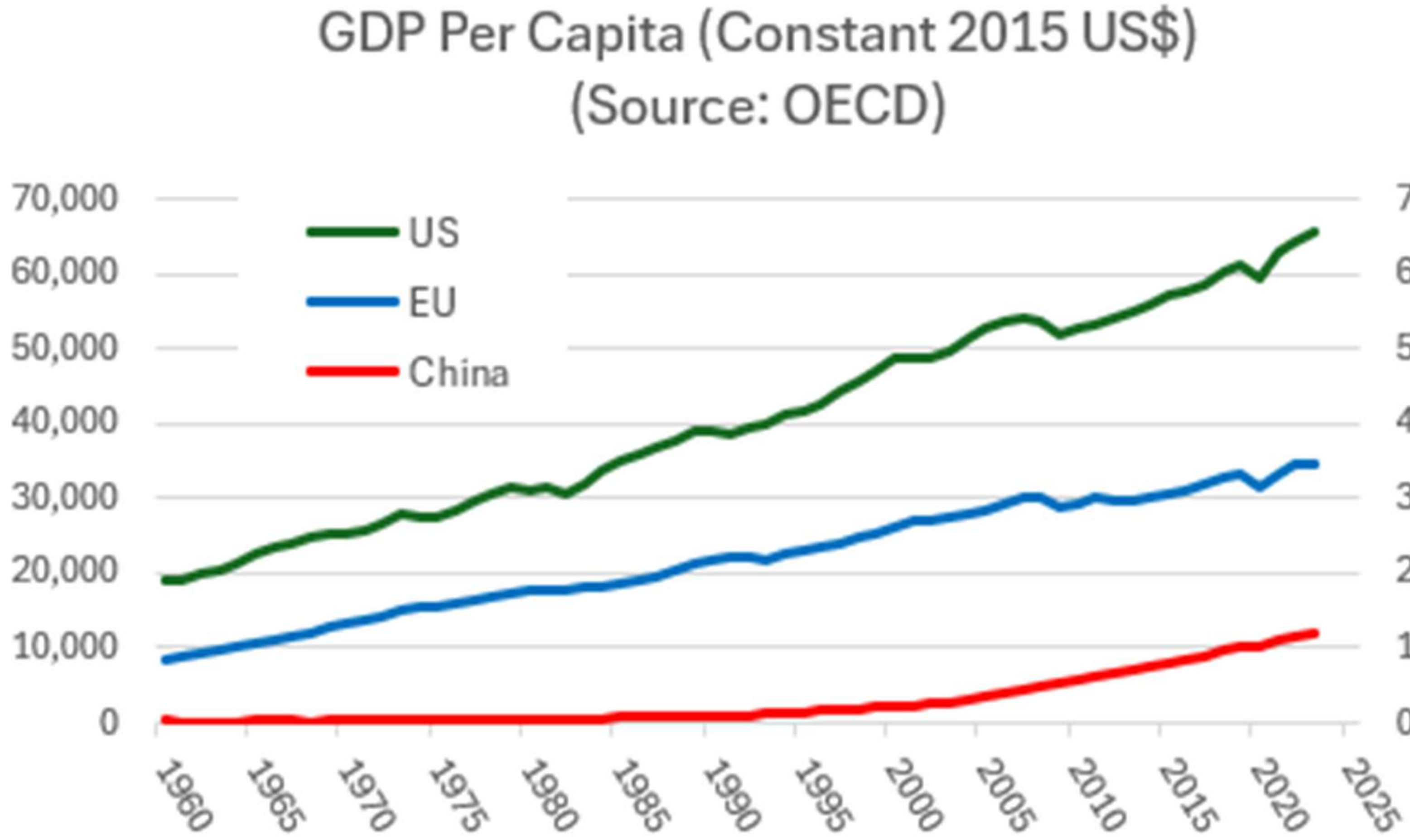
- I have a deficit in trade in goods with Tesco (in fact I don't sell them anything)

- I fund this deficit by selling services to someone else, and from investment income
- If I spend beyond my means and run up a huge credit card bill, it is not Tesco's fault!

10. Trade is a win-win

- Trump assumes trade is a zero-sum game
- In reality, the economic benefits from trade come at least as much from imports as from exports
- The import of goods and services increases choice and competition, drives down prices, and can help to boost productivity
- Exports are simply one way to pay for imports
- Countries can also run persistent (but small) deficits for long periods (and some should!)

11. “The EU and China have sucked the life out of the US economy”



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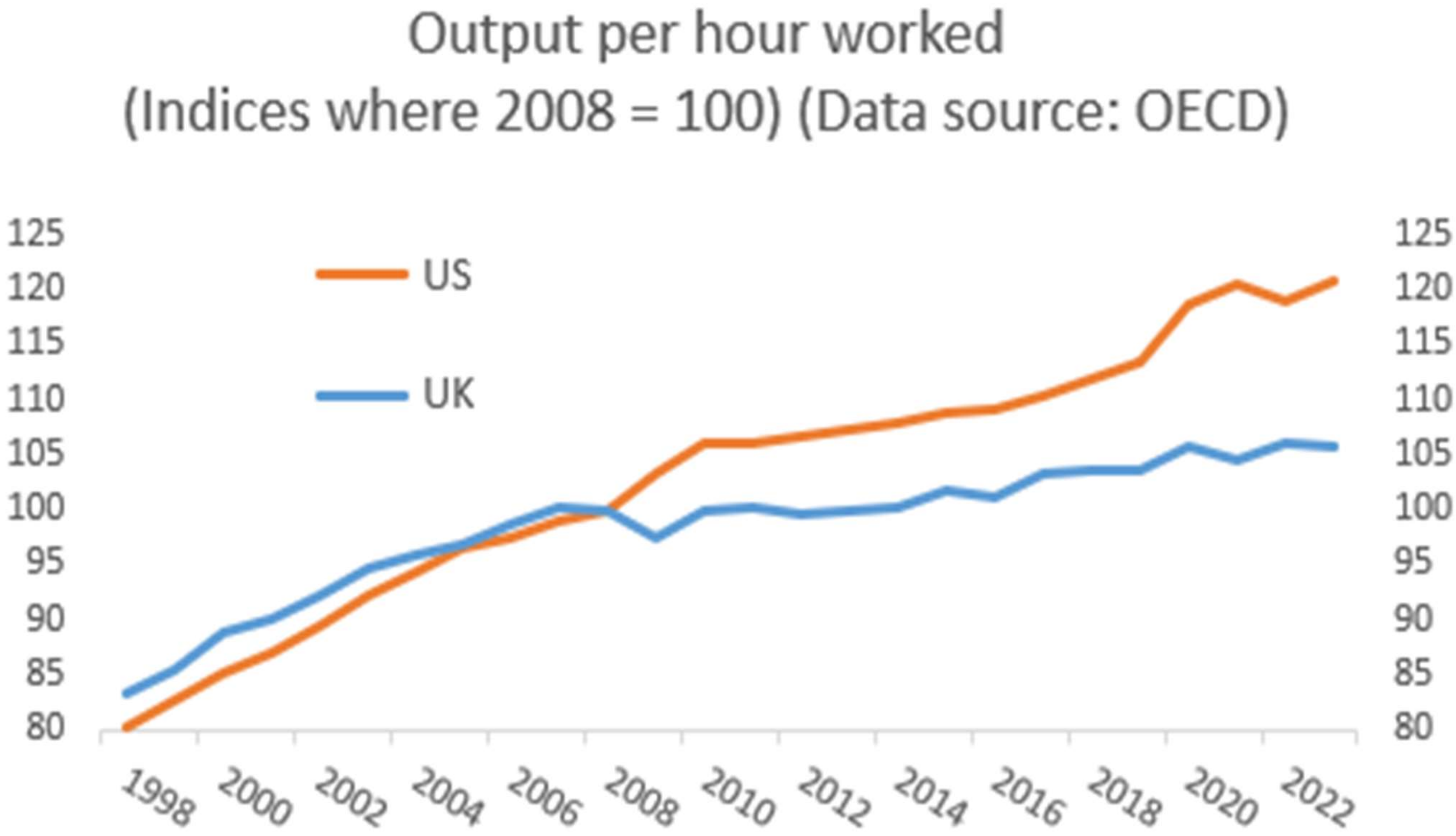
12. Much smaller 'productivity puzzle' in the US



13. Won't tariffs "bring jobs back home"?

- Both theory and experience show that any jobs gained in protected sectors are more than offset by losses in others, as prices rise and productivity falls.
- Can the US really replicate Vietnam's low-cost manufacturing model in Ohio, even if it were desirable to do so?
- US unemployment is already near historic lows
- Most of the additional revenue from tariffs will ultimately come from US taxpayers

14. What does this mean for China?

- Trade is a win-win, so both the US and China will lose
- A collapse in exports to the US might knock 1-2% off China's GDP, but additional fiscal and monetary support should keep growth above 4%
- This could be the start of a global shift: other economies are looking to reduce dependency on China too, and boost domestic industries
- BRICs nations are competitors more than allies
- In particular, India could gain at China's expense

15. What does this mean for the UK?

- A global tariff war should hit the UK economy less hard than many others
- Most of our trade with the US is services
- ‘First in the queue’ for a tariff deal
- Challenge is to balance the ‘EU reset’ with the benefits of Brexit, including new trade deals with the rest of the world and better regulation
- UK interest rates also often track those in the US, so higher inflation there is a problem here too

16. What next?

- Some say crazy tariffs are just a bargaining tool to bring others to the negotiating table ("Art of the Deal")
- But in any event, Trump will have to continue to back down in the face of economic reality
- The adverse reaction in financial markets shows that the US tariff threats lack credibility
- US baseline tariffs will probably settle around 10%, so still higher than before
- But other countries might lower their own trade barriers, so there might be some upside elsewhere

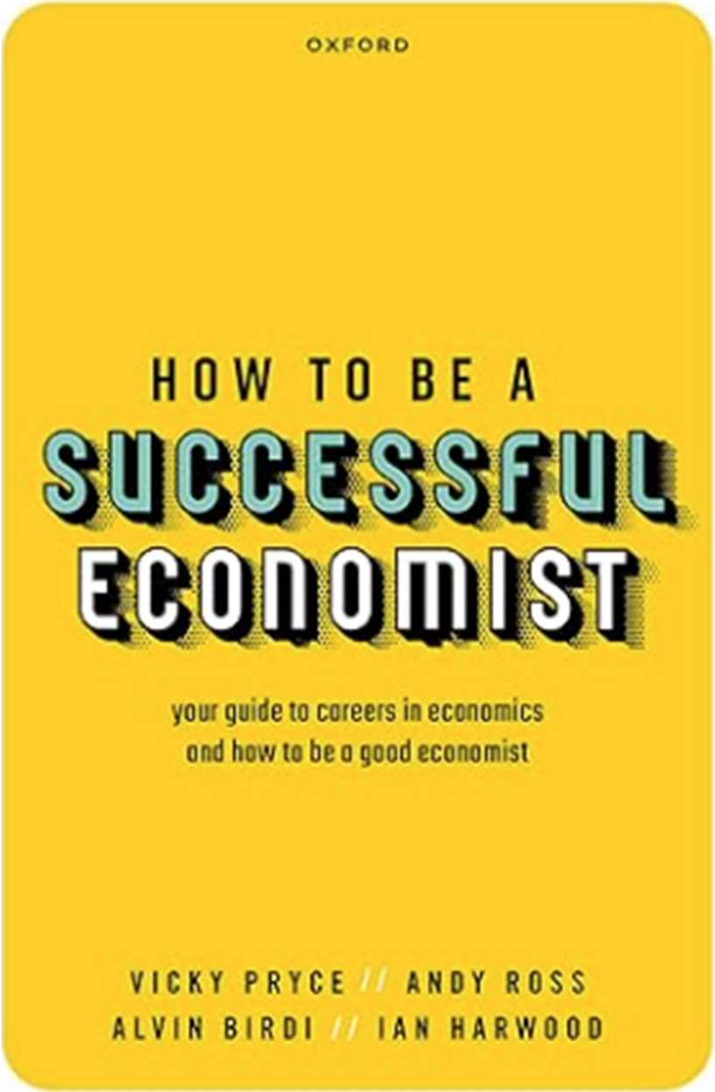
17. The US-UK 'Trade Deal'

(beware US puff – every element here is dodgy!)

18. Favourite parts of my job

1. Reacting to fast-moving events and interpreting their implications for the economy and financial markets
2. Applying a toolbox of economic skills and concepts to solve a wide variety of 'real world' problems
3. Communicating potentially difficult economic concepts to non-economists, including politicians, investors and the general public, via charts, presentations, blogs, media work etc

19. Recommended book - and a film!



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Any questions?

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