What to make of Trump's tariffs

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1. Outline

- What is ‘Trumponomics’?
- Why Trump “loves” tariffs
- Arguments in favour
- The current state of play
- The case against
- Impact on the UK
- What next?
- Questions and discussion

2. ‘Trumponomics’

1. Massively increase US tariffs on imports
2. Permanently extend some tax cuts made in 2017 and add some more (e.g. raise child tax credits, end Federal tax on tips and overtime)
3. Reduce immigration and aggressively increase deportations of “undocumented workers”
4. Shift back from “clean energy” to oil and gas
5. Rebalancing Federal spending with cuts in some areas (notably Medicaid and education) offset by increases elsewhere (especially defence)

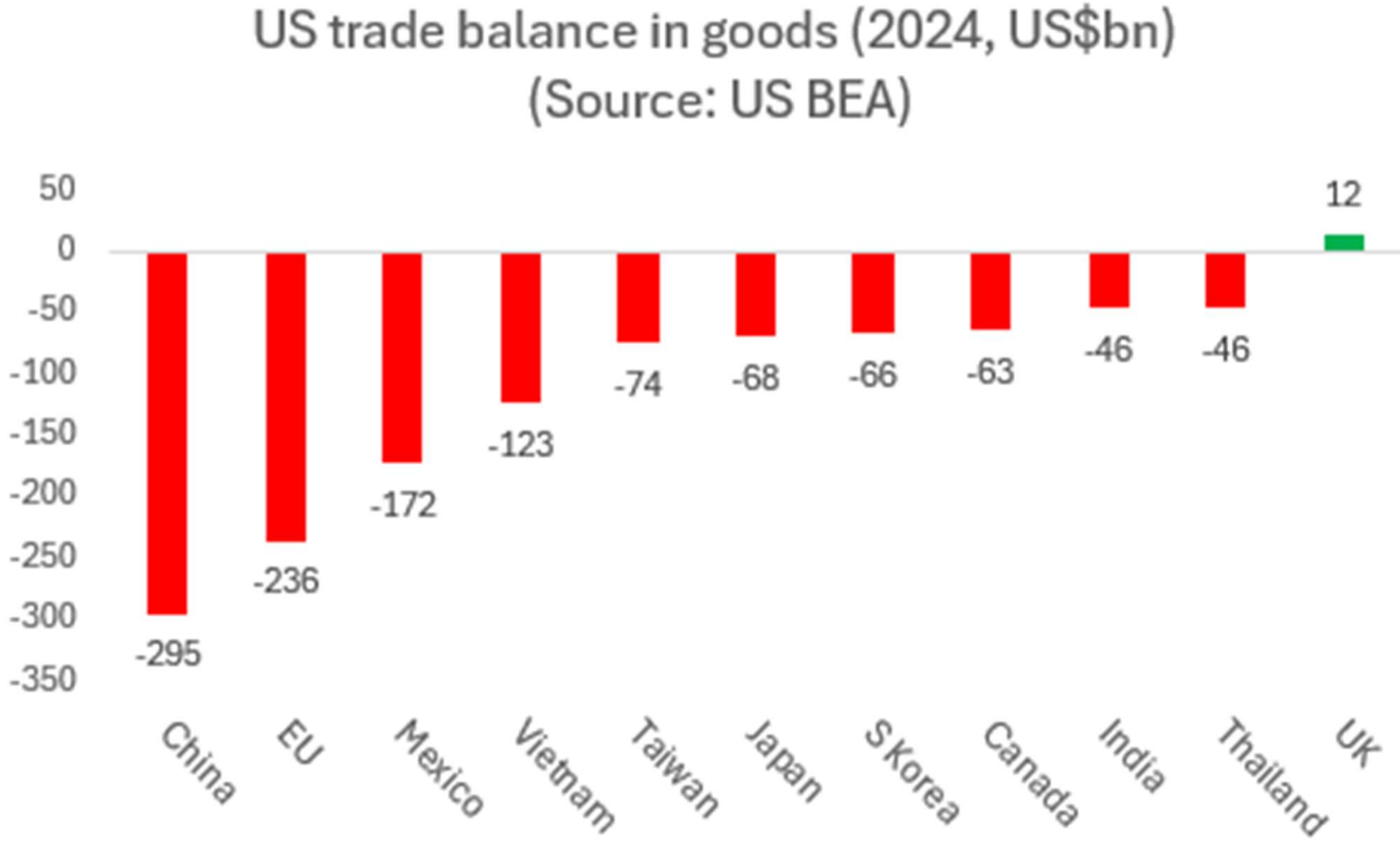
3. Why Trump "loves" tariffs

- Trump makes these economic arguments
  1. "trade deficits are inherently bad"
  2. "tariffs bring jobs back home"
  3. "tariffs are paid by foreigners"
  4. "tariffs will raise lots of revenue for the US"

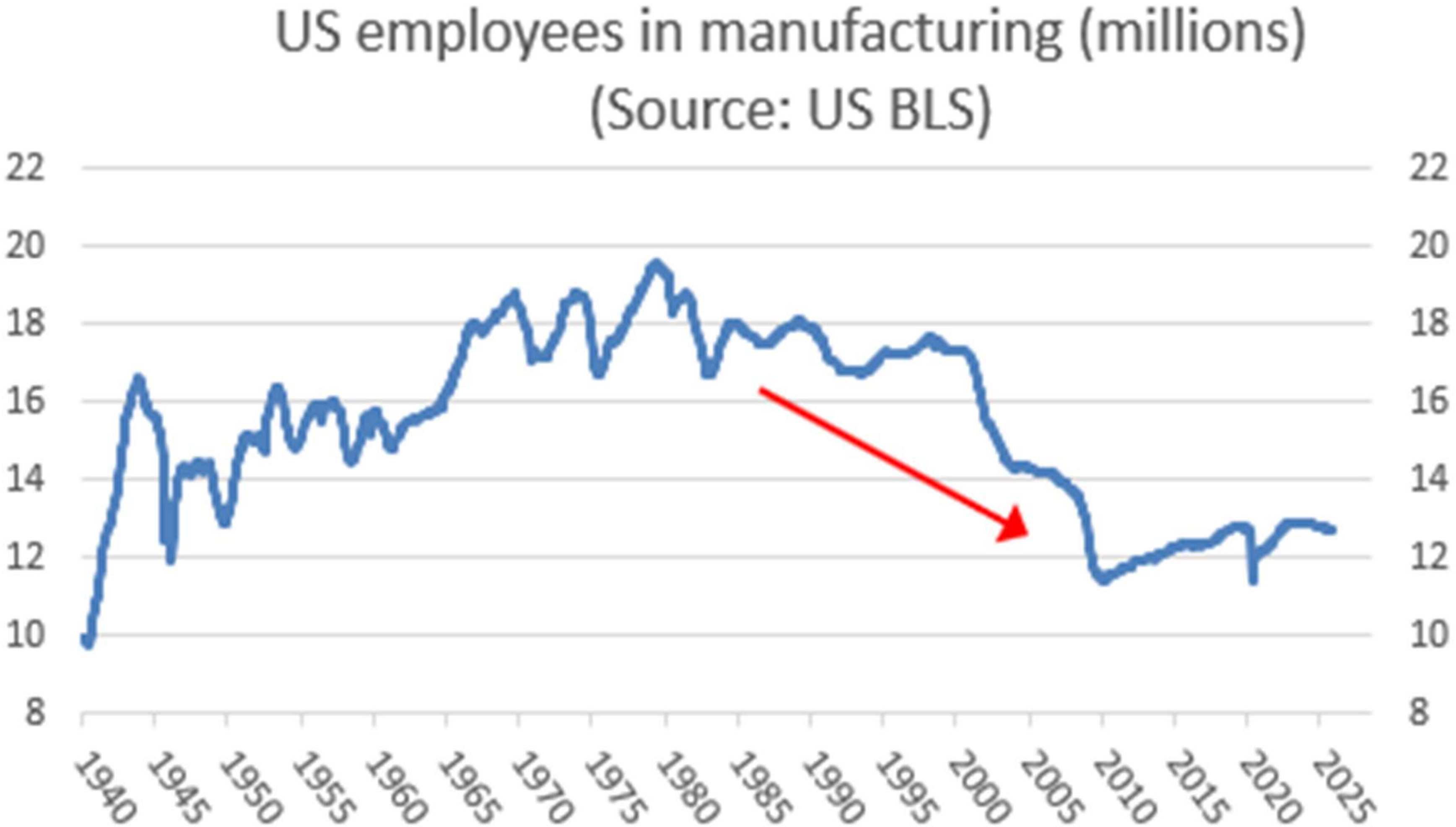
- He also uses tariffs as political leverage, e.g. against India for buying Russian oil…

- …and for national security reasons, e.g. reducing dependency on China

4. The US runs large trade deficits in goods



5. “More than 6 million manufacturing jobs lost!!”



6. The simple economic case for tariffs

- Trump says tariffs are necessary to correct for cheating by countries running surpluses with the US
- Artificial trade barriers include:

  1. tariffs on imports
  2. other taxes that discriminate against US firms
  3. non-tariff barriers, such as product standards
  4. currency manipulation (preventing appreciation)
  5. export subsidies and other state support
  6. ‘dumping’ goods at below cost

7. The "savings glut" argument

- Some economists also argue that trade imbalances are due to excess savings in surplus countries, notably China, Germany, Japan, and the richer Gulf states
- They produce more goods than their own consumers are able (or willing) to buy, forcing export-led growth
- The excess savings are used to buy assets in other countries, which allows these other countries to run large trade deficits (at least for a while)
- A savings glut also depresses interest rates, supports excess borrowing, and create financial bubbles

8. The latest state of play

- The US now has a bewildering array of tariffs:

  1. baseline “reciprocal tariffs”
  2. sector-specific tariffs, e.g. on cars and steel
  3. punitive country-specific tariffs, e.g. on China
  4. a wide range of discounts, notably on pharma, fuels, and some electronic goods (even from China), which may or not be temporary…

- The average effective US tariff on imports has risen from around 3% to around 17% (similar to the average after the Smoot–Hawley Tariff Act of 1930…)

9. What are 'reciprocal tariffs'?

- On 2 April, Trump announced (though then suspended) 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 would apply – based on the size of the deficit relative to total goods trade between the two countries

10. How reciprocal tariffs are calculated

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

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)

ϕ = pass-through from tariffs to import prices (just 0.25)

11. Does any of this make sense?

- There are some legitimate concerns about trade distortions, including excess savings, but tariffs are a crude way to tackle these problems
- The US has assumed that artificial barriers can be proxied by the size of the deficits (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’)

12. An imperfect 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 my services to someone else, and from investment income
- If I spend beyond my means and run up a huge credit card bill, it's not Tesco's fault!

13. Trade is actually a "win-win"

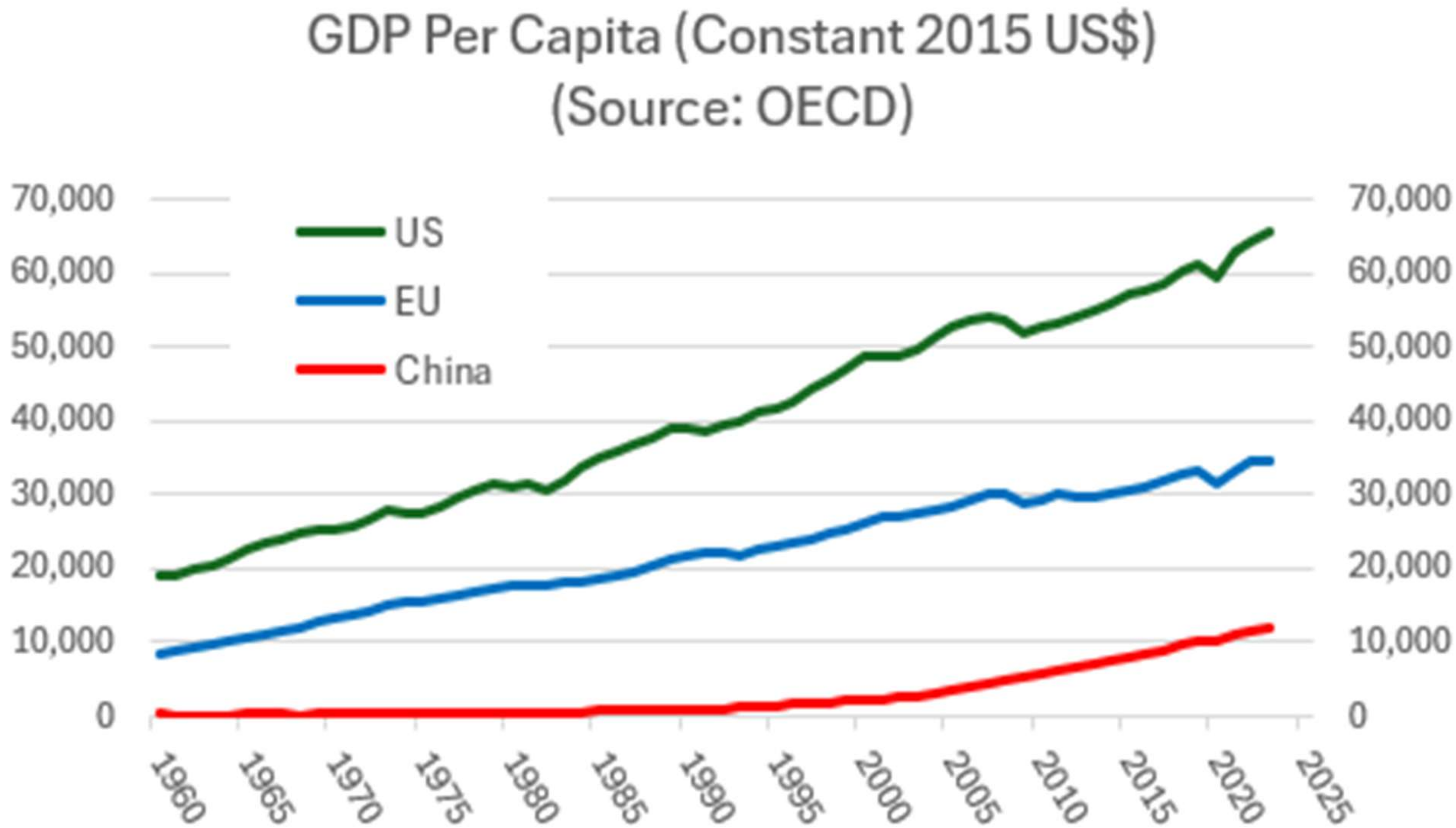
- Trump assumes trade is a zero-sum game and that any deficit is inherently bad (sadly, he's not alone)
- In reality, the economic benefits from trade come at least as much from imports as from exports
- The import of goods and services increases choice and competition, drives down prices, and can help to boost productivity
- Exports are simply one way to pay for imports
- Countries can also run persistent (but small) deficits for long periods

14. But don't imports subtract from GDP?

$$GDP = C + I + G + (X - M)$$

- Imports (M) have a negative sign in the GDP identity, which is often interpreted to mean that imports "reduce" GDP
- But this is simply to avoid double counting, because imports contribute to C, I, and G
- Put another way, higher imports allow higher consumption, investment, and gov't spending

15. Have trade deficits with the EU and China really “sucked the life out of the US economy”?



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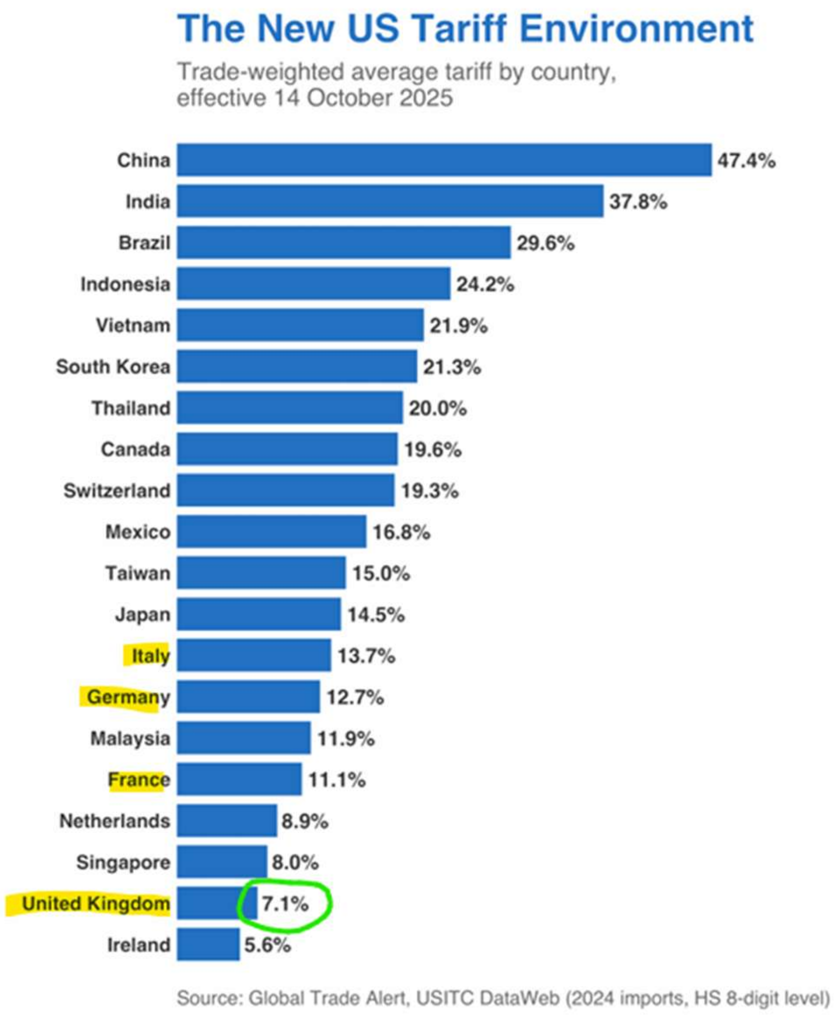
16. Won’t tariffs “bring jobs back home”?

- Both theory and experience suggest that any jobs gained in protected sectors will be more than offset by losses in others
- Trump’s steel tariffs in his first term are estimated to have cost $900,000 a year for every job ‘saved’
- Can the US really replicate Vietnam’s low-cost manufacturing model in Ohio, even if it were desirable to do so?
- Despite fewer jobs in manufacturing, US unemployment is relatively low

17. Won’t tariffs be paid by foreign producers?

- Even evidence cited by the administration suggests that most of the costs of tariffs will ultimately be borne by US companies and households
- Most of the additional revenue from tariffs will therefore come from US taxpayers!
- There is little sign that tariffs are feeding through to US consumer prices, but this may just be a matter of timing: pre-tariff stocks are still being run down, and US companies may be waiting to see if tariffs stick…

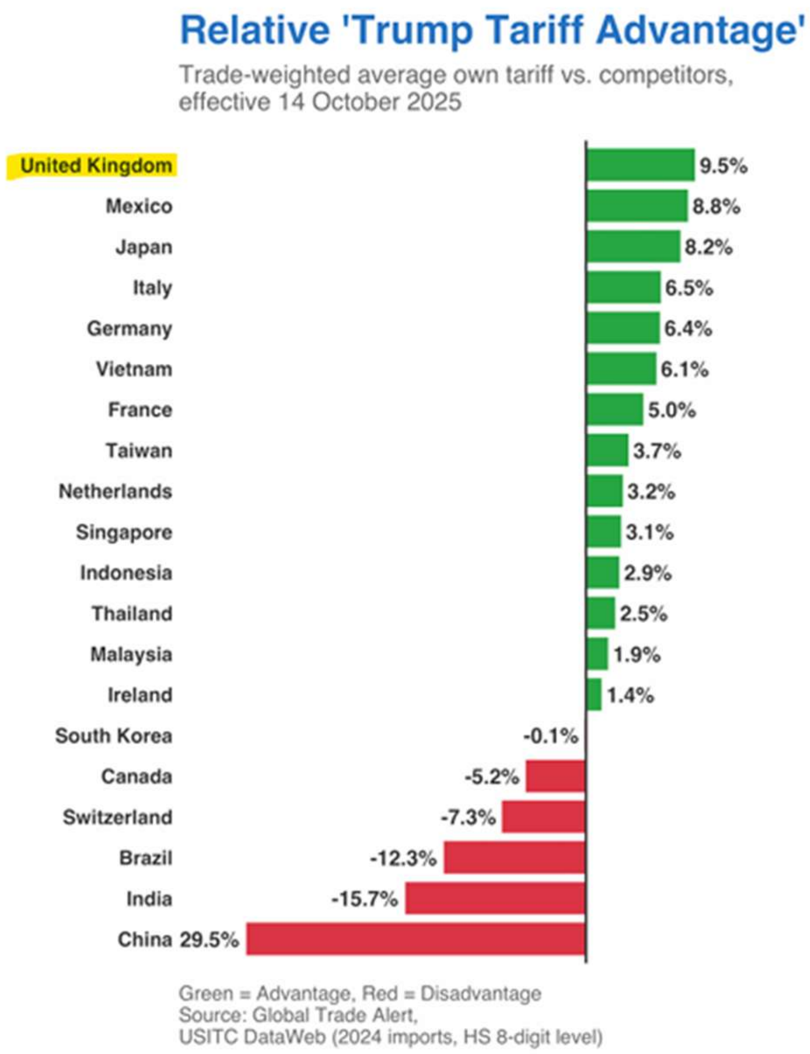
18. A snapshot (as of 14 October)



- The tariffs on Ireland are relatively low, for now, largely due to the exemptions for pharmaceuticals
- Average US tariffs on the UK are lower than those on Germany, France or Italy, partly thanks to Brexit

https://globaltradealert.org/reports/Relative-Trump-Tariff-Advantage-Chart-Book

19. Trump’s tariffs favour the UK



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- This metric compares each country’s *trade-weighted* tariff rate for exporting to the US against the average rate faced by its competitors *on the same products*
- A positive value (advantage) means a country’s products face lower tariffs, on average, than its rivals

20. The wider impact on the UK economy

Channel	UK activity	UK inflation	Explanation
Expenditure switching	↓	↓	US demand for UK exports weakens.
Weaker global demand due to counter-tariffs	↓	↓	Additional trade distortions weigh on global demand, weakening demand for UK exports.
Supply chain disruptions	↓	↑	Supply chain disruptions due to missing components could lead to short-term price spikes.
Trade diversion	↔	↓	Other countries lower prices of exports previously destined for US.
Exchange rate movements	↑ ↓	↑ ↓	Sterling could appreciate or depreciate depending on other countries' trade policies and changes in global risk sentiment.
Long-term supply chain reconfiguration	↓	↑	Reorganisation temporarily reduces global supply capacity and increases price pressures.
Lower competition and knowledge transfers	↓	↔	Reduced trade openness weighs on global potential supply growth.

Bank of England Monetary Policy Report February 2025

21. 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 in April shows that the US tariff threats lack credibility, but the AI boom has been a welcome distraction
- 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

Any questions?

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