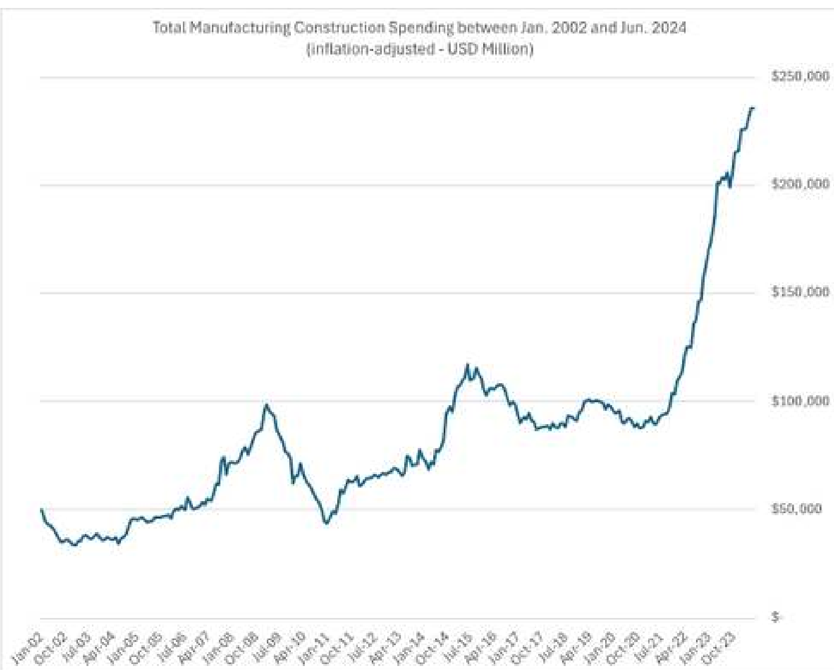
Unpacking the Rhetoric and Myths About Tariffs: Strategically Used Tariffs Are Key Industrial Policy Tools, Essential for Trade Enforcement, and *Don't Necessarily Raise Consumer Prices*

- Strategic tariffs are sometimes needed to develop industries vital to economic and national security. Tariffs are a defense against unfair imports that would otherwise fill domestic demand and deprive U.S. producers a fair market, thus chilling investment in new capacity or crushing domestic production.
- Tariffs are also a primary tool of trade enforcement. The term "trade sanctions" refers to tariffs. Tariffs are used to combat other countries' unfair trade and other commercial practices.
- Tariffs alone will not build new production capacity, ensure Americans have reliable access to goods, or improve our security. But combining them with tax, investment, procurement, and other industrial policy tools has fostered the greatest investment in construction of new U.S. manufacturing plants in 30 years and 150,000 more U.S. manufacturing jobs than at any time in the Trump administration.
- Tariffs affect wholesale prices to signal to retailers and manufacturers sourcing inputs to purchase elsewhere and to countervail unfair advantages such imports would have in their target country. But tariffs do not necessarily raise retail prices. Factors include whether there are domestic goods or non-tariffed imports to substitute for tariffed goods, whether a good has a large wholesale-to-retail markup, and whether there is price competition in a sector. That is why large across-the-board tariffs on all goods from all nations are likely to have a larger impact on consumer prices than targeted tariffs.

Tariffs Are a Bipartisan Tool Used for Decades Here and By Many Nations to Build Critical Manufacturing Sectors, Enforce Trade Law, and Counter Unfair Imports



Source: Data retrieved from FRED, Fed. Reserve Bank of St. Louis

The United States has important economic and national security goals that require building capacity to produce microchips, solar equipment, electric vehicles, and more. Achieving this will require tax and other incentives to spur investment in U.S. manufacturing as well as targeted tariffs to stop unfair imports of the same products.

Industrial policy investment combined with a tariff defense is how the Biden-Harris administration generated the highest rate of investment in U.S. factory construction in 30 years. The use of diverse policy tools developed a path to future manufacturing jobs, economic and climate resilience—and lower prices by breaking monopoly import supply chains with new U.S. production.

During the pre-pandemic Trump years, U.S. manufacturing investment was stagnant even after sizeable tariffs were imposed. Investment only boomed in late 2021 after the infrastructure bill was passed. Then, after enactment of the Inflation Reduction Act and the CHIPS and Science Act in April 2022, a record set in fall 2015 was surpassed. Since then, the monthly numbers have consistently grown.

Who Pays for Tariffs?

Donald Trump said foreign countries pay tariffs charged by the United States, which is wrong. U.S.

retailers that sell lots of imported products, like Walmart, say consumers pay, which is also wrong. U.S. consumers do not pay the government for tariffs. Tariffs are paid by importers to a government agency called Customs and Border Protection. Tariffs are a cost that companies face if they choose to import products that have a tariff charge. **Tariff costs are not necessarily passed on in consumer prices.**

Tariffs Do Not Automatically Translate to Higher Retail Prices for Consumers

U.S. consumers only pay tariff costs if corporations that choose to import products or inputs also choose to pass on tariff costs and charge consumers higher prices. By design, tariffs raise wholesale prices of a target good. Tariffs signal to retailers or input buyers to get a targeted good elsewhere. Sourcing shifts if a domestic product or a non-tariffed one from another country is available for less than the tariffed price. Thus, a substitute good will be less expensive than the tariffed price. When Chinese goods faced U.S. tariffs in 2018-2020, many retailers and manufacturers found new suppliers.

If no alternatives exist, the tariff is paid. But, even then, retailers and manufacturers may not pass on the tariff cost. A group of prominent researchers studying retailers' response to the Trump-era China tariffs found that retailers either were not raising consumer prices or doing so only modestly. **"Our results suggest that retailers are absorbing a significant share of the increase in the cost of affected imports by earning lower profit margins on those goods."** [1] Even in instances when the researchers found that retail prices did rise, it was unclear this was tariff related. One example cited in many press stories was explored by the researchers—washing machines. They found that retail prices for certain goods and brands increased not only in the United States, but also in Canada where no tariffs applied. This called into question if tariffs or other factors were the cause of the increased prices.

As well, news coverage often confuses the findings of this study and others that note that "the costs were borne domestically" not in the exporting country. That finding is another way of saying that the exporter did not lower prices to compensate for the tariff but rather the U.S. importers paid the additional tariff cost. *This is different than saying that U.S. consumers paid for the tariffs.*

Whether the consumer retail price increases depends on many factors. Because tariffs are charged on wholesale prices, not retail, even a 30% tariff on $120 Nikes likely would not affect the price. Nikes retailing at $120 are landed at a wholesale price of around $15/pair. The price is set based on what consumers will pay, not the production cost. A $5 tariff is easily absorbed in a $105 profit. Tariffs are also not necessarily passed on in goods with smaller markups. When a retailer or manufacturer faces competition, they may decide not to raise prices to avoid losing market share. [2] Such retail pricing considerations, as well as expansive substitution of other goods for tariffed Chinese ones, in part also explain why inflation was flat in the 2018-19 period when Trump raised tariffs significantly on certain Chinese goods. These factors are also why across-the-board tariffs on all goods from all countries without exception would likely raise consumer prices while targeted tariffs are considerably less likely to do so.

Across-the-Board Tariffs on All Goods from All Nations Likely to Raise Retail Prices

Whether tariffs raise prices depends on *how* tariffs are used. Especially if applied indefinitely, sizeable across-the-board tariffs could raise retail prices on items for which the United States is heavily import reliant. This is especially the case if long term tariffs were applied to *all goods from all countries without exemptions*, including for goods simply not produced here. Across-the-board tariffs have been used in the past as a bargaining tool. Richard Nixon's August 1971 10% across-the-board tariffs, imposed at a time of

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[1] Alberto Cavallo, Gita Gopinath, Brent Neiman, and Jenny Tang, "Tariff Passthrough at the Border and at the Store: Evidence from US Trade Policy," *National Bureau of Economic Research* Working Paper Series (2019), https://www.nber.org/system/files/working_papers/w26396/w26396.pdf.

[2] Matt Stoller, "Corporate Profits Drive 60% of Inflation Increases," BIG by Matt Stoller, accessed August 21, 2024, https://www.thebignewsletter.com/p/corporate-profits-drive-60-of-inflation?s=r.

high inflation and unemployment, were lifted after four months having succeeded in shocking Germany, Japan, and other nations into adjusting currency values as the Bretton Woods gold-backed currency regime ended. When targeted tariffs are used for trade enforcement against specific countries or products, retail price impacts can be minimal. The same is true for targeted tariffs to stop unfair imports during periods of industrial policy investment, especially if this increases domestic production capacity.

Are Tariffs Allowed Under Global Trade Rules and the Multilateral Trade System?

Given that tariffs are the quintessential trade policy tool, they are thoroughly regulated by the multilateral trading system and, as a rule, permitted. The 1947 General Agreement on Tariffs and Trade (GATT) established a framework for countries to negotiate the reduction of MFN tariffs at the multilateral level. (The GATT was incorporated as one of the agreements now enforced by the World Trade Organization (WTO).) Moreover, the GATT rules contemplated the use of antidumping and countervailing duties as legitimate policy tools to deal with unfair imports that harm or could harm domestic industries. The WTO includes a chapter setting rules on when such tariffs may be imposed.

While a GATT objective was the reduction of tariffs, its framework anticipated the need to renegotiate tariff levels, potentially raising them, despite previous commitments. Indeed, GATT Article XXVIII includes a process for countries to withdraw or modify previously offered tariff levels. Unlike trade remedies provisions, Article XXVIII does not set out specific conditions under which additional tariffs may be applied. Instead, it establishes a procedure under which, subject to certain constraints, any tariff concession can be withdrawn for any reason for an indefinite period of time. Countries have used this right repeatedly. Just between 1994 and 2017, there were 43 renegotiations under Article XXVIII.[3]

Who Thinks What About Tariffs?

Firms that profit by offshoring factories and selling goods here made overseas want low tariff rates. They spend millions on lobbyists and PR to demonize tariffs altogether and falsely claim that tariffs cause inflation and other economic harms. Many economists also tend to hate tariffs as a matter of faith.

Polling shows that tariffs, especially against Chinese imports, are popular[4] with many Americans. Diverse American voters think[5] that tariffs are the best way to counter trade cheating by other nations.

Voters in swing states hard hit by the China trade shock (Michigan, Wisconsin, Pennsylvania, Ohio, etc.) view the use of tariffs as a proxy for ‘standing up for me on trade.’ In early 2024, the “China Shock” research team used the Cooperative Election Study[6] polling data to overlay their findings that voters in congressional districts hardest hit by imports from China shifted significantly to voting Republican in 2020 even where tariffs imposed by President Trump had not delivered jobs. They write that these voters value use of tariffs “as a sign of political solidarity”[7] rather than for economic impact.[8] A common myth is that high tariffs enacted in the June 1930 Smoot-Hawley Tariff Act caused the Great Depression. But the Great Depression in fact started a year earlier in August 1929.

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3 Anwarul Hoda, Tariff Negotiations and Renegotiations under the GATT and the WTO: Procedures and Practices, Second Edition (Cambridge University Press, 2018), 163, https://www.wto.org/english/res_e/publications_e/tariff_neg2_e.htm.

4 “National Tracking Poll, Project: 2306006,” Alliance for American Manufacturing, last modified June 2023, *https://www.americanmanufacturing.org/wp-content/uploads/2023/06/2306006_topline_AAM_RVs_CT-1.pdf*.

5 Elizabeth Brotherton-Bunch, “New Poll Finds Likely GOP Voters Really Want Action on Manufacturing (and They Support Tariffs, Too),” Alliance for American Manufacturing, last modified September 26, 2023, https://www.americanmanufacturing.org/blog/new-poll-finds-likely-gop-voters-really-want-action-on-manufacturing-and-they-support-tariffs-too/.

6 “Cooperative Election Study,” Harvard University, accessed August 21, 2024, https://cces.gov.harvard.edu/.

7 David Autor, Anne Beck, David Dorn, Gordon G. Hanson, “Help for the Heartland? The Employment and Electoral Effects of the Trump Tariffs in the United States,” *National Bureau of Economic Research* Working Paper Series (2024), https://www.nber.org/system/files/working_papers/w32082/w32082.pdf.

8 Ana Swanson, “Trump’s Tariffs Hurt U.S. Jobs but Swayed American Voters, Study Says,” *New York Times*, February 2, 2024, https://www.nytimes.com/2024/02/02/us/politics/trump-tariffs-jobs-voters.html.

How Are Tariffs Used for Trade Enforcement?

U.S. manufacturers sometimes petition the U.S. government to put tariffs on products made under unfair conditions to equalize the price so their domestic good is not crushed by unfair imports. Depending on the tariff rate, it may incentivize producers in another country to end an unfair practice, level the playing field so that domestic producers can compete or, if it is high enough, effectively freeze out a product.

The Data Are Clear: Tariffs Do Not Correlate to Higher Inflation

As the figure to the right shows, government data show no correlation between higher tariffs and increases in U.S. inflation. The U.S. inflation rate remained relatively stable between July 2018-February 2020 when President Trump steadily raised tariffs on Chinese goods. In 2021, President Biden cut some tariffs, but inflation went up, not down.

Source: Data retrieved from FRED, Fed. Reserve Bank of St. Louis, and Peterson Inst.

BACKGROUND: A tariff is a fee collected at the border on a good that comes from another country. Tariff payments go to government treasuries. Countries set tariff rates. A country's "Most Favored Nation" (MFN) tariff rate applies to its trade with most other nations unless a "free trade" pact eliminates virtually all tariffs. MFN rates are not reciprocal. There are also penalty tariffs used to counter trade cheating: If a product is dumped (sold in another nation at a price below its cost of production) or unfairly subsidized, the importing country can impose a tariff to "countervail" the unfair benefit (these are called antidumping and countervailing duties or trade remedies). Tariffs were the main revenue source for the U.S. government when the country was founded. Today, tariff rates are at historic lows although most countries have some tariff peaks, which are higher tariffs on specific sensitive goods. Measured at the rate actually applied by countries and with a mean that is weighted to reflect what goods are actually traded, the United States average is 2.2% and European Union 2.7%, Japan 1.9%, Canada 3.4%, China 3%, Mexico 3.9%, and Australia 2.5%.[9]

For more information, please contact: info@rethinktrade.org.

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[9] "World Tariff Profiles 2024," WTO, ITC, and UNCTAD, accessed August 21, 2024, https://www.wto.org/english/res_e/booksp_e/world_tariff_profiles24_e.pdf.