Insight

# Evidence that Americans Pay for President Trump's Tariffs

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## Executive Summary


- President Trump has imposed tariffs – that is, levied taxes – on over $300 billion worth of imports, with $258 billion from China alone. These taxes are increasing costs by up to $69 billion per year.
- President Trump claims that the Chinese are paying for these tariffs either by intentionally devaluing their currency or by subsidizing their businesses, but recent data indicate that these actions are unlikely to counteract the tariffs.
- Research instead shows that the costs of tariffs thus far have been completely passed on to U.S. consumers, raising prices in affected sectors and harming the economy by depressing both imports and exports.


## Introduction

President Trump has been extremely critical of U.S. trade practices. He has unilaterally imposed new tariffs on over $300 billion of U.S. imports, citing as justification either national security concerns or unfair Chinese trade practices. The legal justification for the tariffs, whether they will have any meaningful impact on the trade deficit, or their effectiveness as a negotiating strategy is debatable. The economic reality, however, is that the president's tariffs are increasing costs by up to $69 billion per year. These costs raise the billion-dollar question: Who is footing the bill?

## The Fundamentals of Tariffs

Tariffs are taxes on the purchase of foreign-made products. Tariffs can be imposed for a multitude of reasons, but their result is to make foreign goods relatively more costly than U.S. goods. When the United States imposes a tariff, the tax is paid by Americans who purchase imports, whether the purchaser is an individual or a business. Take this example – under President Trump, bicycles and certain bicycle parts made in China are subject to a new 25 percent tariff. If a U.S. retailer imports these bikes to sell here in the United States, the retailer must pay 25 percent of the purchase price to Customs and Border Protection. Similarly, when China imposes a retaliatory tariff on the United States, which it has on over $100 billion of U.S. exports, those tariffs are paid by Chinese purchasers of American-made goods.

The immediate result of these tariffs is easy enough to figure out: According to the Treasury Department, Americans have paid $45 billion in total customs duties thus far in FY2019 – 80 percent more than at this point last year ($25 billion) and the highest amount on record. But just because U.S. importers are paying the duty up-front does not mean that the money is ultimately coming out of their pocket.

## The Different Ways of Paying for Tariffs

There are a number of different ways that affected parties can pay for tariffs. One possibility is that U.S. importers will bear the entire cost of the tariff after it has been imposed. If that is the case, businesses must absorb these costs by either accepting lower profits, reducing their future workforce and investment plans, passing the tariffs on to consumers through price increases, or some combination of these responses.

U.S. companies can also look for new suppliers in either the United States or a non-affected country. The products from that new supplier, however, will almost certainly come at a higher cost than the pre-tariff status quo – and these increased costs are an indirect way of paying for the tariff. Furthermore, pre-existing contracts, business relationships, and the general state of trade uncertainty brought about by the president’s tariff policies may make the switch difficult in the short term.

Alternatively, China could be paying the $69 billion tariff bill, as President Trump contends. China could do so in a couple of different ways. The first is if China’s currency loses value relative to the U.S. dollar, either via economic forces or currency manipulation. A devaluation of the Yuan could make the dollar strong enough to absorb the tariffs without forcing price increases in the United States. The second is if China subsidizes its producers, allowing them to decrease pre-tariff export prices to the United States enough to offset the tariffs and keep trade flows constant.

**Are the Chinese Paying for the Tariffs?**

President Trump repeatedly claims that the Chinese government is paying for his tariffs by subsidizing Chinese businesses, which would in turn enable them to lower their prices. Large Chinese subsidies are not new, so this response from the Chinese certainly is possible. Recent data released by the Export-Import Bank, however, show that financing from Chinese export credit agencies have not substantially increased since the imposition of the tariffs. While Chinese subsidies to exporting firms are nearly four times greater than those in the United States, medium- and long-term export credits remained relatively unchanged from 2017 to 2018 (at around $40 billion). Short-term export credits did increase to $481 billion from $412 billion, but this increase is in line with recent trends. While these export credits could be helping Chinese companies to absorb the impact of the tariffs, it is unlikely that these subsidies were imposed in response to the president’s tariffs or that they are fully offsetting the additional cost.

If these subsidies were paying for the tariffs, import prices would be falling. Indeed, since the first round of tariffs were imposed on China in July 2018, pre-tariff import prices for Chinese goods have fallen 1.4 percent, the continuation of a 7-year trend in decreasing goods prices from China. At the same time, in response to retaliatory tariffs against the United States and the negative impact of trade tensions on the global economy, prices of U.S. goods to China have dropped nearly 4 percent. This drop has caused the purchasing power of U.S. exports in terms of imports, called the terms of trade, to decline by 3 percent.

The president has also contended that China has nullified the tariffs by devaluing its currency. This argument would only be valid if the Chinese Yuan has lost enough value relative to the dollar to counteract the new U.S. tax on imports. The following chart shows how the U.S.-China bilateral exchange rate has changed over the past two years.


The chart shows that the bilateral exchange rate has remained relatively unchanged, sitting at nearly 7 Yuan per dollar both at the beginning of 2017 and the beginning of 2019. The Yuan did depreciate 2 percent against the dollar following the imposition of the tariffs in July 2018, but this drop does not necessarily support the president's assertion of currency manipulation. The relative depreciation of the Yuan is exactly what economic theory predicts – tariffs depress imports, lowering the availability of dollars in China and lowering demand to convert those dollars to Yuan. As a result, the return on Yuan deposits falls, causing depreciation. Depreciation is also a result of China's slowing economy, the growth rate of which was on a downward trajectory prior to the tariffs, and the trade tensions are only further slowing China's economic growth. Not only is the stronger U.S. economy placing upward pressure on the value of the dollar, but U.S. tariffs are themselves driving down the value of the Yuan.

**Are U.S. Consumers and Businesses Paying for the Tariffs?**

Evidence suggests that U.S. consumers, not the Chinese, are shouldering the burden of President Trump's recent tariffs. One study from the National Bureau of Economic Research (NBER) estimated that 100 percent of the tariffs were passed on to consumers. Specifically, it found that the domestic prices of affected goods increased between 10 and 30 percent following the tariffs, while export prices charged by China and others did not significantly change. At the same time, imports of affected products fell 25 to 30 percent and imports of unaffected products rose 10 percent, suggesting the tariffs caused U.S. importers to substitute away from China. Altogether, NBER estimates that the president's tariffs are causing a welfare loss (measured as a loss in real U.S. income) of $1.4 billion per month as of November 2018. If the tariffs bring back all manufacturing jobs lost over the last 10 years, one of the president's stated goals, the new tariff policy would result in a $195,000 welfare loss per one manufacturing job saved, according to the paper – a loss almost four times as great as the annual wage of a steel worker.

Another NBER study arrived at similar conclusions using a different methodology. Like the previous study, this study found that the tariffs were completely passed on to consumers: It estimates the tariffs caused import quantities to decline by 23 percent but the value of imports, including tariffs, to rise by 9 percent. Similarly, in response to retaliatory tariffs imposed by China, the quantity of U.S. exports fell by 25 percent but the tariff-inclusive export prices rose by 19 percent, indicating that the Chinese are paying for their own retaliatory tariffs. Furthermore, it did not find any evidence that U.S. tariffs caused foreign exporters to reduce their pre-tariff prices. In fact, a one percent increase in the applied U.S. tariff was found to increase the cost of U.S. imports by 1.09 percent. Using a general equilibrium framework, the study estimates that U.S. consumers lost $68.8 billion due to price increases, protected U.S. producers gained $21.1 billion due to increases in producer prices, and the aggregate loss for the United States was $7.8 billion.

**Conclusion**

Observers have been quick to question whether the president's tariffs are having a negative economic impact. The evidence indicates that they are: Producers in affected sectors are passing the tariffs to consumers, U.S. exporters are losing access to foreign markets, and overall U.S. income is lower than it would be otherwise. Neither Chinese subsidies nor currency manipulation are meaningfully diminishing these negative impacts.

These harmful effects have persisted despite the administration's claim that it is selectively imposing tariffs on products that can be easily substituted for non-tariffed goods. If the president chooses to move forward and impose tariffs on all imports from China, however, there would be no protecting U.S. consumers. As each new tariff is imposed, the economic harm will only multiply.