Research

The Cost of Reciprocal Trade

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Executive Summary

- President Trump has advocated for reciprocal trade—i.e. equal imports and exports with another country—since first taking office in 2017. Now, the White House is pushing a new bill that would give the president expanded authority over trade policy and the power to enact reciprocal tariffs.
- Tariffs increase costs for both American producers and consumers. This analysis finds that imposing a new reciprocal trade policy through equal tariffs on our current trade partners could increase nationwide prices by over $60 billion per year, not counting the cost of retaliation.
- Reciprocal tariffs would be a significant blow to the U.S. economy. The most effective way to lower trade barriers facing U.S. exporters is not to impose additional tariffs, but to enter into cooperative trade agreements with other nations.

The Problem with Reciprocal Tariffs

Since his election, President Trump has touted "free, fair, and reciprocal trade" as one of the primary goals of his administration. New White House-backed legislation was recently introduced in the House of Representatives to achieve this aim—namely, by dramatically expanding presidential authority over trade policy. The legislation, called the Reciprocal Trade Act, would impose new trade barriers in an effort to improve the trade balance. The reality, however, is that restricting international trade has a clear cost to both American consumers and businesses, who are forced to bear the brunt of any new tariffs.

Reciprocal trade in principle would suggest that the United States buys from another country the exact same dollar amount that it sells, resulting in a bilateral trade balance of zero. There are several problems with this goal. First, the world is not made up just two nations. Americans benefit from having the choice of 200 countries to trade with, making bilaterally balanced trade nearly impossible and effectively meaningless. Second, the efficiency gains and economic growth generated by trade is a direct result of comparative advantage. Each nation produces and sells what it is best at making, ensuring that the productivity of U.S. companies increases and consumers enjoy the widest choice of goods and services at the lowest cost. The reality of comparative advantage does not produce balanced trade, but it does better our standard of living.

In the case of trade barriers, reciprocal trade implies that the tariffs and non-tariff barriers of one country are identical to that of another. Because the United States has relatively low trade barriers compared to the rest of the world, the outcome of reciprocal trade would be a drastic increase in U.S. tariffs. The economic harm caused by tariffs has been shown numerous times and in numerous different ways: They increase prices, decrease capital expenditures and investment, inspire retaliation from our trading partners, and slow economic growth. In this way, reciprocal trade would be a significant blow to the U.S. economy.

Calculating the Cost of Reciprocal Tariffs

What impact might a policy of reciprocal trade have in practice? The simplest result would be the United States

increasing its tariffs to match those of other nations. The Mercatus Center estimates that this policy would increase the total number of products faced with U.S. tariffs by a factor of 10, from around 3,000 to nearly 30,000. A more worrying possibility is that the United States would increase tariffs to even higher levels than its partners, attempting to capture the impact of non-tariff barriers on U.S. exports. Because the latter is very difficult to quantify, the following analysis aims to answer this question by examining tariff rates only.

To see the potential impact that reciprocal tariffs would have on the United States, this analysis applies product-specific Most-Favored Nation (MFN) tariff rates of U.S. trading partners to current import levels. MFN rates for each country are negotiated upon entrance to the World Trade Organization (WTO) and represent the tariffs that WTO members levy on one another. This analysis compares the difference between U.S. tariff rates per product group (as defined by 2-digit HS codes[i]) and those of our trading partners, and then applies the difference to the dollar value of imports in 2017.[ii] If the trading partner has higher tariff rates, the U.S. rate is assumed to rise to an equal level—the assumed outcome of a reciprocal tariff policy. Import levels were taken from the U.S. Census Bureau, and MFN tariff rates were retrieved from the WTO. No reciprocal tariffs are applied to goods traded through current trade agreements, for which there are zero tariffs applied to U.S. exports.[iii]

Because the United States engages in trade with over 200 countries or geographic areas in any given year, this analysis focuses only on the top U.S. trading partners. Specifically, it analyzes the potential effect of reciprocal tariffs on the United States' 16 top trading partners, which together make up about 80 percent of U.S. trade.[iv]

Assuming that current import levels remain unchanged and 100 percent of the cost of the tariff is passed on to consumers, the following table displays the increased costs Americans can expect to face from the imposition of reciprocal tariffs. Because American businesses would likely absorb a portion of the tariffs as well, this analysis produces a potential magnitude, not an exact cost. Even given this caveat, however, it is still a realistic total for what consumers could face: In addition to a direct increase in consumer costs, tariffs increase production costs for businesses, which in turn decrease production and investment and have significant ripple effects throughout the economy. One way or another, tariffs fall back on American consumers.

An Excel sheet with the calculations used can be found here.

Country	2017 Import Levels (Billions $)	Cost of U.S. Reciprocal Tariff (Millions $)
China	506 B	35,332 M
Mexico	131 B*	4,190 M
Canada	169 B*	486 M
Japan	137 B	65 M
Germany	118 B	1,520 M
South Korea	38 B*	1,517 M
United Kingdom	53 B	632 M
Italy	50 B	548 M
France	49 B	546 M
Ireland	49 B	259 M
India	49 B	4,365 M

Vietnam	47 B	4,774 M
Taiwan	43 B	989 M
Malaysia	37 B	1,091 M
Thailand	31 B	2,021 M
Brazil	30 B	1,862 M
Total	**1,535 B**	**60,196 M**

*Excludes imports traded under the North American Free Trade Agreement (NAFTA) and the U.S.-Korea Free Trade Agreement (KORUS)

This analysis finds that imposing reciprocal trade measures can be expected to raise nationwide prices in the United States by $60 billion annually, or approximately $471 per household per year. The highest cost would come from tariffs on China, from which the United States imports over $500 billion annually. Similarly high costs would result from reciprocal tariffs on Mexico, India, Vietnam, and Thailand, all of which are emerging markets that tend to have higher tariffs than developed countries such as the United States.

It is worth noting that there was no available tariff data for an additional $60 billion of combined imports from the above countries. Therefore, the above calculation is an underestimation of the total upward pressure that would be placed on prices. Furthermore, history suggests that our trading partners would likely retaliate against any reciprocal tariffs: Canada, Mexico, China, and other nations retaliated dollar for dollar against U.S. exports following the imposition of national security tariffs on steel and aluminum, and China retaliated further after U.S. tariffs were enacted to combat intellectual property theft.

Conclusion

Reducing trade barriers facing U.S. exports is a noble goal. Reciprocal trade, however, is not the answer: Not only will reciprocal tariffs hurt U.S. consumers and increase manufacturing costs in the United States, but they will also raise global tensions and further escalate trade wars. Instead, the United States should aim to reduce as many tariffs and non-tariff barriers as possible through cooperative trade agreements.

[i] The Harmonized System Classification sorts products into specific groupings, for which unique tariff rates apply.

[ii] The increase in U.S. tariff level expected from reciprocal tariffs is defined by the foreign country's MFN tariff rate minus the U.S. MFN tariff rate

[iii] The trade agreements in question are the North American Free Trade Agreement (NAFTA) and the U.S.-Korea Free Trade Agreement (KORUS). The dollar value of goods traded under these agreements is available from the U.S. International Trade Commission's DataWeb. To determine the dollar value of goods not traded under these agreements, and thus subject to reciprocal tariffs, we subtract the value of imports from Canada, Mexico, and South Korea traded under the agreements from the total value of imports from those nations.

[iv]Switzerland, the United States' 15th top trading partner in 2017, was excluded due to limited available tariff data.