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Tariffs of the Trade

Outlook for Trade Policy Amid the 2024 Election

Economist(s)

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Summary

Many of the tariff policies enacted during the 2018-19 trade war remain in place today. Looking through pandemic-related effects, tariffs have increased costs for domestic importers and led to a diversification away from Chinese imports. The president has near-unilateral power when it comes to trade policy, and as such, we expect it to come into greater focus headed into the 2024 election. In this note, we recap current trade policy and its impact on economic growth, as well as offer some guideposts on the trade outlook in the context of a Trump or Biden presidency.

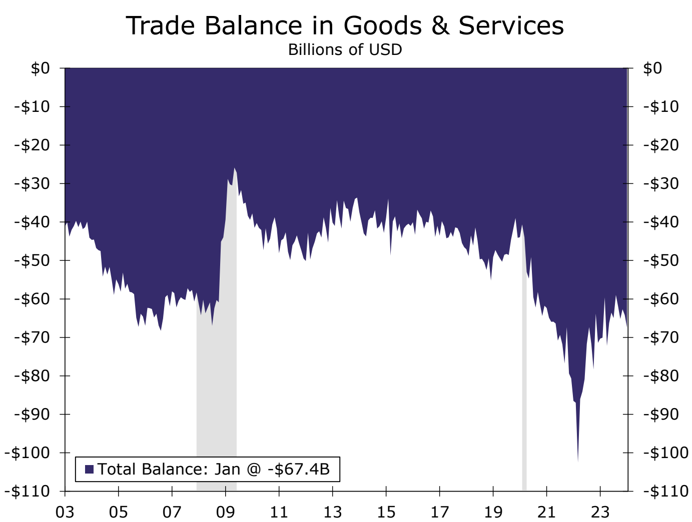
- The Trump administration took a protectionist stance on trade policy. Most tariff policy put in place in 2018 and 2019 remains in effect today. The Biden administration has made only minor changes. Countries have retaliated with tariffs of their own, but we focus on U.S.-imposed tariffs and their effect on imports and domestic demand in this report.
- The U.S. trade-weighted average tariff rate on merchandise imports from the world remains elevated today compared to where it was before the trade war began, mostly due to the high tariffs on Chinese goods. Tariff costs have largely been absorbed by domestic importers and, although bumpy due to the pandemic, have led to a diversification away from dutiable goods.
- U.S. goods imports from China have retreated more sharply than from other Asian countries (South Korea, Singapore, Taiwan, Vietnam). With overall imports higher today, tariffs have ultimately led to a movement away from China to suppliers in other countries rather than a surge in domestic production.
- Importers still face higher costs and have passed on some of these costs to households in the form of higher prices. While tariffs can be inflationary, the overall inflationary impact of the trade war in the context of the broader U.S. economy has been rather minimal, particularly in the wake of the pandemic.
- Given the president has near-unilateral power through the executive branch when it comes to trade policy, the trade environment may garner more attention come the 2024 election, particularly in the event of a divided government (i.e., Democratic president and Republican-controlled Congress or vice versa), which typically leads to political gridlock and only incremental policy changes from Congress.
- We expect more pronounced changes if the Republicans secure the White House. If former President Trump is re-elected, we may see an escalation in tariffs; he has proposed a 10% baseline tariff and increasing the current tariff rate on China to 60%.
- A re-elected President Biden would likely stay the course on trade policy. The status quo is notable in itself, however, as it demonstrates both candidates have similar objectives for the country's trade relations with China, at least to some degree.
- A continuation of protectionist policy, or potential escalation, can add fodder to ongoing deglobalization. The inflationary impact of additional tariffs could be partially absorbed in the near term because suppliers' margins are elevated and diversification away from already tariff-exposed product is in train. But if consumer goods are directly targeted, we would expect to see some price pressure as retailers' margins are lean, leaving them less nimble today in a rising cost environment.

Situational Awareness

The U.S. international trade balance has narrowed considerably after a sharp widening in the wake of the pandemic's disruptions. In January, the trade deficit in goods and services was $35B smaller than it was at its widest point in early 2022 and sat only $21B wider than its pre-pandemic average (Figure 1). The normalization, which was helped along by softening goods imports and stable services exports over the past year (Figure 2), has occurred without any major trade policy overhauls. That is, much of the trade-related policy that was put in place during the Trump administration remains in effect today, with some tweaks from the Biden administration in recent years.

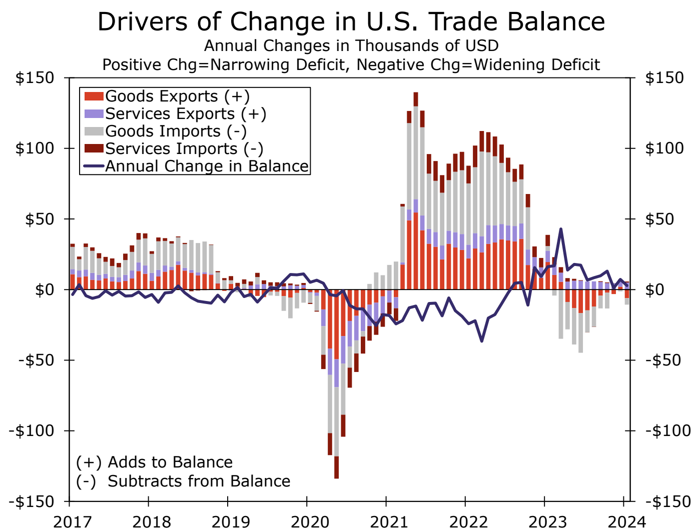
While these policies have withstood the transfer of powers, the 2024 presidential election has injected fresh uncertainty into the path of U.S. trade. Our colleagues previously set the stage for the 2024 election and its potential effects on the economy generally; in this note, we focus on trade specifically. We recap current trade policy and its impact on economic growth, as well as offer some guideposts on the trade outlook in the context of a Biden or Trump presidency.

Figure 1



Source: U.S. Department of Commerce and Wells Fargo Economics

Figure 2



Source: U.S. Department of Commerce and Wells Fargo Economics

Let's Recap

As a quick recap, the Trump administration took a protectionist stance on trade policy that began with national security and domestic industry safeguard investigations in 2017 and ultimately led to sweeping tariff policies in 2018 and 2019. The first few rounds of tariffs were indiscriminate in terms of trading partners—they targeted certain goods and affected multiple countries. The later rounds targeted many goods and China in particular.

As outlined in our *Tariff Tear Sheet*, most policy put in place during the trade war remains in effect today. The Biden administration has amended which trading partners are excluded from certain tariffs, and to what extent they are excluded, but the underlying restrictions remain largely the same today as when they were first enacted. Other countries have retaliated with tariffs of their own, but we focus on U.S.-imposed tariffs and their effect on imports and domestic demand in this report.

U.S. Tariff Tear Sheet

Date Enacted	Law	Current Tariff Rate	Targeted Goods	Value of Goods Affected (At Policy Enactment)	Trading Partners Affected	Current Trading Partners Excluded	Developments
Active Tariffs							
Jan 2018	Section 201	15%	Solar panels	$8.5B	Multiple	Cambodia, Malaysia, Thailand, Vietnam	Originally set to expire in Feb 2022, extended by Biden Administration in 2022
Mar 2018	Section 232	25%	Steel	$23.4B	Multiple	Argentina, Australia, Brazil, Canada, Mexico, South Korea, Ukraine, EU*, UK*, Japan*	Biden Administration has amended trading partners excluded
Mar 2018	Section 232	10%	Aluminum	$16.4B	Multiple	Argentina, Australia, Canada, Mexico, EU*, UK*	Biden Administration has amended trading partners excluded
Jul 2018	Section 301 (List 1)	25%	Intermediate inputs & capital equipment	$34B	China	--	Biden Administration has made some modifications, such as reinstating previously excluded goods, excluding other goods, and offering rebates to affected companies
Aug 2018	Section 301 (List 2)	25%	Intermediate inputs & capital equipment	$16B	China	--	Biden Administration has made some modifications, such as reinstating previously excluded goods, excluding other goods, and offering rebates to affected companies
Sep 2018	Section 301 (List 3)	25%	Intermediate inputs & capital equipment	$200B	China	--	Biden Administration has made some modifications, such as reinstating previously excluded goods, excluding other goods, and offering rebates to affected companies
Sep 2019	Section 301 (List 4A)	7.5%	Consumer goods	$300B	China	--	Biden Administration has made some modifications, such as reinstating previously excluded goods, excluding other goods, and offering rebates to affected companies
Expired Tariffs							
Jan 2018		-	Washing machines	$1.8B	Multiple	--	Allowed to expire in Feb 2023

**Excluded up to a quota, tariffed thereafter*

Source: U.S. Department of Commerce, Office of the United States Trade Representative, Pearson Institute for International Economics and Wells Fargo Economics

With the earliest policies now in place for six straight years, we can more confidently tease out their effects. In a simplistic sense, tariffs are a tax on imports. Tariffs are often imposed to protect domestic industry by making foreign goods more expensive for domestic consumers and businesses, which will ideally promote demand for local product and spur domestic production in the longer run. As the trade war imposed hefty tariffs on in-demand Chinese goods—an estimated $550 billion worth of U.S. imports from China were affected at the time of enactment—the higher costs borne by U.S. importers has supported a pivot away from Chinese product in recent years.

All Is Not Fair in a Trade War

So, how big of a deal have tariffs been really? Taking a step back, the U.S. trade-weighted average tariff rate (i.e., tariff revenue collected by the United States on all products imported from a given country as a percentage of the total value of those imports) on merchandise imports from the world remains elevated today compared to where it was before the trade war (Figure 3). Much of that is due to the tariffs on Chinese goods.

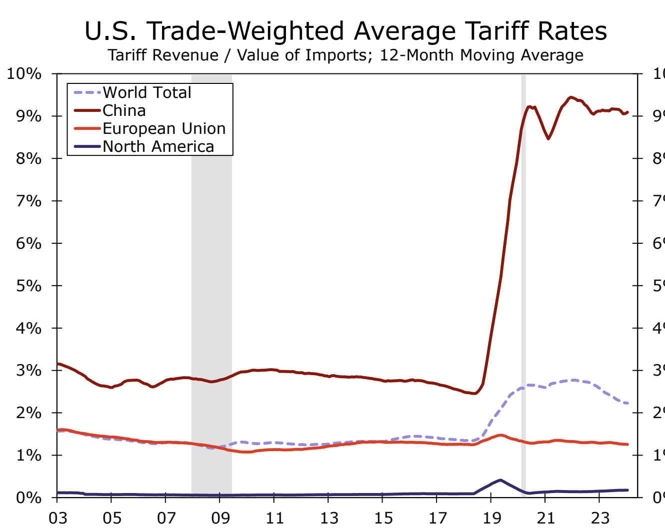
Specifically, the Chinese products subject to the additional duties enacted under Section 301 have had an average tariff rate of around 20% since 2019. Yet, the U.S. *trade-weighted* average tariff rate on Chinese merchandise imports has hovered around 9%.[1] Strong domestic demand for Chinese goods that were never subject to tariffs, such as computer monitors, laptops, phones and toys, has weighed on tariff revenue from Chinese imports.[2]

We also saw some evidence that U.S. importers were starting to substitute away from Chinese goods before the pandemic struck, which has likely weighed on tariff revenue as well. As shown in Figure 4, U.S. imports of Chinese goods started to decline following the policy enactments in 2018. Imports from the European Union picked up over that period, while imports from Asian countries outside of China gradually rose and stabilized in late 2019 and early 2020.

Goods imports plummeted across the board when the pandemic struck. But once the initial lockdown period faded, U.S. demand quickly ramped up. The initial result was an aggressive drawdown in inventories which left many businesses with little flexibility to pivot away from tariff-impacted suppliers if they had not done so already. Taken together with quickly rising input costs, U.S. imports of Chinese goods gradually ramped up over 2021 and 2022 back toward its pre-trade war level.

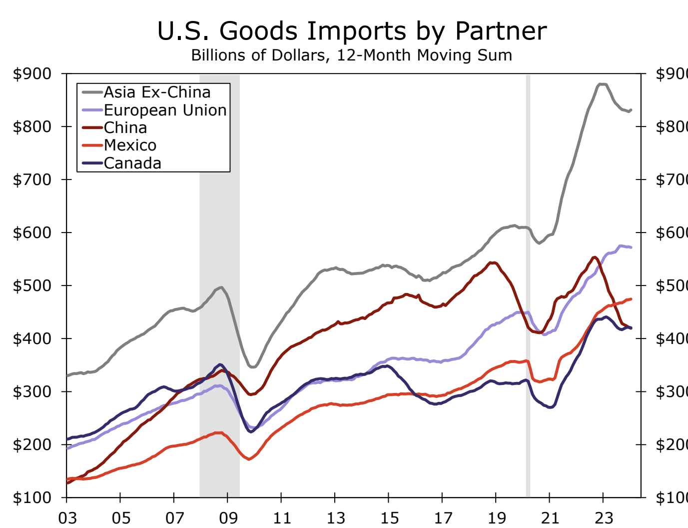
More recently, however, U.S. goods imports from China have retreated sharply, while those from other Asian countries have continued to trend higher, which underscores how U.S. importers are continuing to move their suppliers out of China. On a nominal basis, merchandise imports from China ended 2023 *down* 3% relative to 2019, while imports from South Korea (+50%), Singapore (+52%), Taiwan (+60%) and Vietnam (+68%) strengthened.

Figure 3



Source: U.S. Department of Commerce and Wells Fargo Economics

Figure 4



Source: U.S. Department of Commerce and Wells Fargo Economics

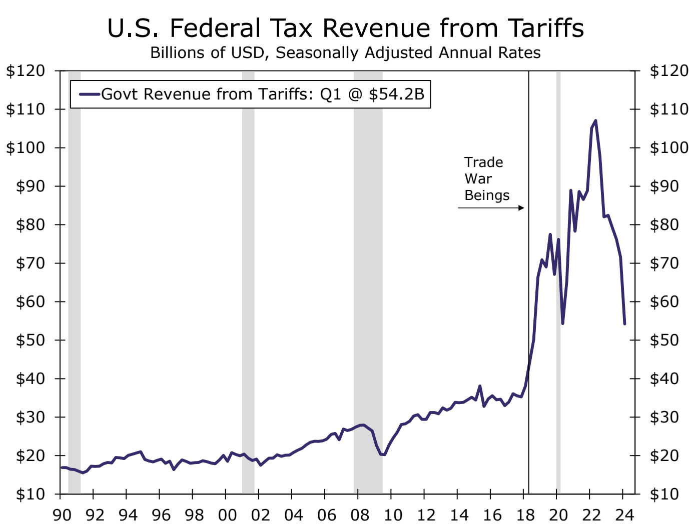
While the dramatic upturn in imports from places in Asia other than China shows how U.S. importers have responded to the trade war by diversifying their suppliers, it is not as though the trade war has been the only factor. The pandemic's devastating effect on supply chains, heightened political tensions between the United States and China and rising Chinese labor costs have likely affected the reallocation of suppliers as well. Yet even as these factors complicate the assessment of the trade war's *direct* impact, several studies have concluded that the United States is actually worse off due to the tariffs, at least in the short run. If the goal of the trade war was to reduce dependence on Chinese imports, this reallocation of suppliers suggests it has been successful, but it is not as though this transition has come without cost.

The U.S. International Trade Commission estimated that the Section 232 tariffs increased domestic production of steel and aluminum in 2021 but also increased selling prices, which led to negative downstream effects. Production in industries that use steel and aluminum as inputs, such as motor vehicle parts and business equipment manufacturing, saw production decline 1% on average in 2021 due to the tariffs.[3] Limited downstream production exacerbated the procurement challenges facing many companies in 2021 and 2022 as they were left scrambling for inventory as consumer spending ramped up.

Perhaps most significantly , the tariffs levied on Chinese imports were costly for U.S. importers. Researchers at the National Bureau of Economic Research collected evidence of a "complete tariff passthrough rate" to U.S. importers through 2021.[4] In other words, rather than Chinese exporters lowering their selling prices in the wake of tariffs to somewhat offset the additional cost and support continued demand from U.S. importers, the tariffs increased the price that U.S. importers paid for Chinese goods by the *full amount* of the tariff. Separate research has found that Chinese exporters were able to divert their merchandise flows to other countries, which supported Chinese export prices and likely contributed to the complete tariff passthrough rate to U.S. importers; thus over 2018-2021, the United States was the price taker in the trade war.[5]

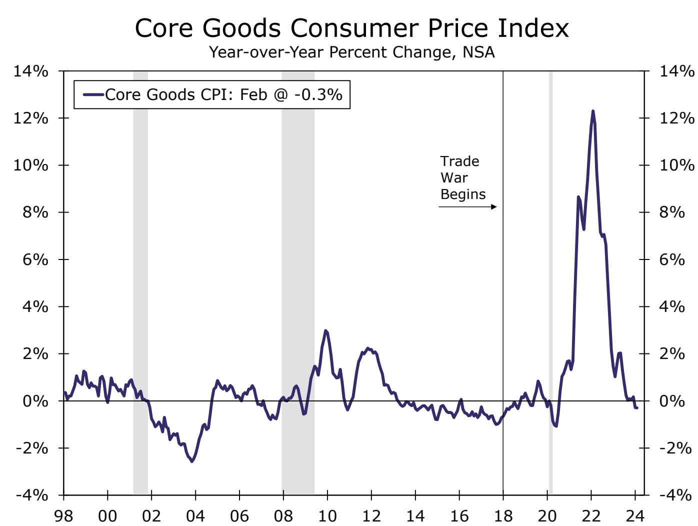
Consequently, net receipts paid to the U.S. government in the form of customs duties shot higher once the trade war began (Figure 5). Even as tariff revenue has slowed amid weaker import growth and less demand for tariff-exposed product, the fact that revenue remains higher today than it was prior to the trade war highlights the still-elevated cost burden on U.S. importers. There is some evidence that domestic importers have in turn passed at least some of these costs onto consumers by raising selling prices or charging higher fees. Researchers at the Federal Reserve Bank of New York found that the 2018 tariffs carried a $830 average annual cost per household due to higher tax payments and market efficiency loses in 2019.[6]

Figure 5



Source: U.S. Department of the Treasury and Wells Fargo Economics

Figure 6



Source: U.S. Department of Labor and Wells Fargo Economics

Yet in the context of the broader economy, the trade war's effect on consumer prices looks to have been less impactful. As seen in Figure 6, the Consumer Price Index for commodities excluding food and energy (i.e., core goods) was rising just ahead of the pandemic. After averaging a 0.4 percentage point *decline* on a year-over-year basis in the five years prior to the trade war, the core goods CPI averaged essentially flat growth over 2018 and 2019 when the trade war policies went into effect. Thus, core goods prices went from being nearly a 0.1% *drag* on the overall annual rate of CPI, on average, to being a 0.1 percentage point *boost* in the wake of the trade war. In other words, tariffs helped stomp out the deflationary trend emanating from core goods prices. That said, the tariffs did not immediately result in a meaningful push higher in consumer prices, especially when compared to the bout of inflation during the pandemic.

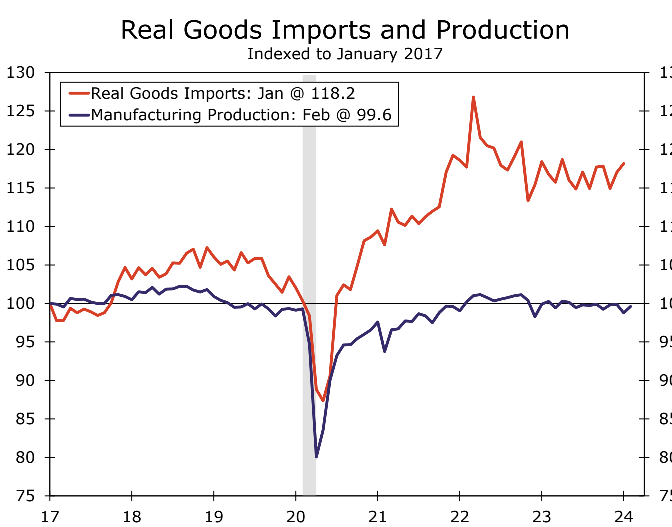
The fact that most of the tariffs targeted intermediate inputs and capital equipment (revisit the *Tariff Tear Sheet*) helps explain why there was a more minimal direct impact on consumer prices. The federal government's overarching objectives when enacting tariffs were to protect domestic industries from foreign competition and eventually support domestic production. It is difficult to argue those objectives have been accomplished considering the path of U.S. production in the intervening years. Manufacturing production ended 2019 about 1% below its 2017 average. Fast-forward to today and manufacturers have continued to struggle—output sat 0.8% below its 2017 average in February 2024. Since the United States is also importing more goods than it was prior to the trade war (Figure 7), these dynamics further support the idea that the trade war encouraged a shift in global supply chains, rather than spurring an increase in domestic production.

Where Do We Go from Here?

As our colleagues previously discussed, the 2024 election is not just a race for control of the White House but also control of the chambers of Congress. In recent years, a unified government has produced much of the major legislation that has driven shifts in the economic outlook. On the flip side, a divided government (i.e., Democratic president and Republican-controlled Congress or vice versa) has generally led to political gridlock and incremental policy changes. For trade policy, several statutes have granted almost unilateral power to the executive branch. This essentially means the president can change tariffs and trade agreements without requiring approval from Congress. We would expect that in the event of a divided government, the elected president could use their authority over trade to advance their administration's agenda amid gridlock in Congress.

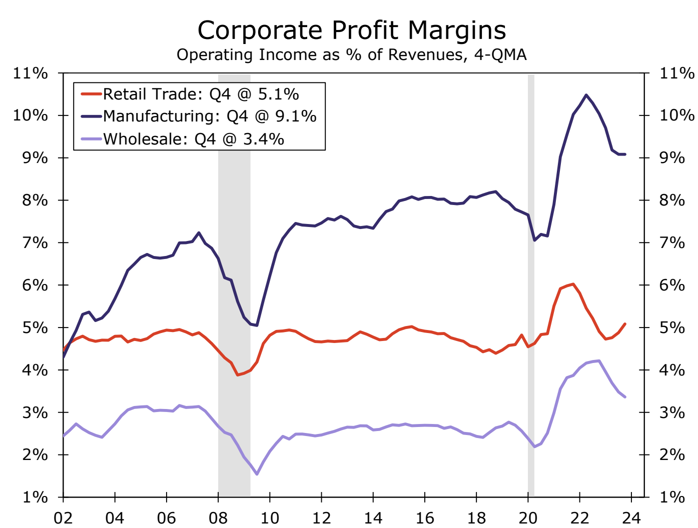
In this election cycle, we ultimately expect more pronounced changes to trade policy should the Republicans secure the White House, regardless of a divided government. If former President Trump were re-elected in November, we could see a re-escalation in the trade war; he recently stated being in favor of a 10% baseline tariff on *all* U.S. imports and increasing current tariffs on Chinese imports to 60% or higher, although no formal proposals have been released. If enacted to the proposed degree, these policies would be a significant escalation to existing trade policy, and they would further increase costs for U.S. importers, place upward pressure on inflation and potentially strengthen the U.S. dollar.

Figure 7



Source: U.S. Department of Commerce, FRB and Wells Fargo Economics

Figure 8



Source: U.S. Department of Commerce and Wells Fargo Economics

Since suppliers' margins are presently elevated (Figure 8), and they have somewhat diversified away from tariff-exposed product, the initial inflationary impact from additional tariffs could be partially absorbed. But even with some room to budge on margins, higher costs would likely translate to higher prices for consumers, particularly if more finished goods are affected by newly enacted tariffs. Retailers and wholesalers already operate under thinner margins than manufacturers, leaving them less room to absorb the higher cost associated with tariffs. Although manufacturers and wholesalers have broadly maintained elevated margins since the pandemic, the retail sector has seen some compression amid a slowing in consumer demand, restocking of inventory and elevated labor costs, which leaves it less nimble in a rising cost environment today than it was five or six years ago during the initial onset of tariffs.

In the event that President Biden is re-elected, we expect trade policy to stay the course. The status quo is notable in itself, however, because the continuation of trade policy enacted under the Trump administration suggests both presidents have similar objectives for the country's trade relations with China, at least to some degree. At the end of the day, a re-elected Biden administration may revisit tariffs enacted on key U.S. allies, such as the European Union and the United Kingdom, but it is unlikely to impart as much of an escalation in trade policy as the Trump administration would, in our view.

Trade Policy Back in Focus Come 2025

Six years after enactment, the trade war's overall effect on the economy has been marginal. Domestic production has essentially held steady, while the surge in consumer price inflation is primarily attributed to the pandemic's disruptions rather than the trade war's tariffs. U.S. importers have faced higher costs due to the tariffs, yet corporate profit margins are elevated and suggest businesses have been able to absorb most of the additional cost. Arguably, the most salient development is the reconfiguration of U.S. import flows as importers diversify away from tariff-exposed product.

A continuation of protectionist trade policy, or potential escalation, can add fodder to ongoing deglobalization in the wake of the pandemic.[7] The reorganization of supply chains does not come without cost and could thus lead to higher prices of imported goods on a sustained basis. Yet, the short-run inflationary impact of tariffs could be mitigated if the dollar strengthens and/or the rise of automation boosts productivity. Heading into a contentious election cycle, the nearly unilateral control of trade policy conferred upon whoever wins the presidency suggests trade policy may again take on greater importance come 2025. Uncertainty surrounding trade policy has already ticked higher to levels last seen at the start of the pandemic, suggesting businesses are attuned to the rising risk.

Endnotes

1 - The U.S. Department of Commerce's estimates of duty can overstate duties collected in situations where U.S. products are returned after processing and assembly abroad. In these cases, duties are typically not applied, but the Commerce Department's calculations apply the levy. Furthermore, articles that are subject to various tariff rates are excluded, which can understate duties collected. (Return)

2 - Bornw, C. "Four years into the trade war, are the US and China decoupling?" Peterson Institute for International Economics. October 2022. (Return)

3 - "Certain Effects of Section 232 and 301 Tariffs Reduced Imports and Increased Prices and Production in Many U.S. Industries." News Release 23-024. United States International Trade Commission. March 2023. (Return)

4 - Fajgelbaum, P. and Khandelwal, A. "The Economic Impacts of the US-China Trade War." Working Paper 29315. National Bureau of Economic Research. December 2021. (Return)

5 - Jiao, Y., Liu, Z, Tian, Z, and Wang, X. "The Impacts of the U.S. Trade War on Chinese Exporters." The Review of Economics and Statistics 2022. Massachusetts Institute of Technology. July 2022. (Return)

6 - Amiti, M., Redding, S.J., and Weinstein, D. "New China Tariffs Increase Costs to U.S. Households." Liberty Street Economics. Federal Reserve Bank of New York. May 2019. (Return)

7 - Bryson, J. et al. "Globalization in Retreat: Implications for the U.S. Economy." Wells Fargo Economics. March 2023. (Return)

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