## ANALYSIS – Macroeconomic effects of higher US import tariffs

The incoming president of the United States, Donald Trump, has said that he wants to raise import tariffs from other countries, especially on goods from China. If they are raised, GDP growth in the both the United States and China would probably be dampened. Inflation in the United States would be higher in the short term. Swedish GDP would probably slow down somewhat, while the effect on inflation in Sweden is uncertain.

During the 1990s and early 2000s, global trade was deregulated. Import tariffs were reduced and trade barriers removed. This led to a rapid increase in global trading. However, over the past ten years, protectionism has increased and an increasing number of new trade barriers have been introduced. Trade barriers for Swedish export companies have increased significantly since 2019, especially for various goods such as motor vehicles, iron and steel.[17] The increased protectionism has often been motivated by an increased focus on national security or protecting domestic industries from competition. One example is the trade conflict between the United States and China in 2018 and 2019, when the United States began by raising import tariffs and China responded by raising tariffs on US goods. Over the past year, both the United States and the EU have raised import tariffs on certain Chinese goods.

The next president of the United States, Donald Trump, has said that he wants to raise import tariffs on goods from all foreign countries. One proposal is to raise import tariffs on Chinese goods to 60 per cent and on all other countries' goods to 10 per cent. The idea is that the higher import tariffs will protect domestic industries from foreign competition and encourage the purchase of domestically produced goods. There is also a hope that the higher import tariffs will reduce the US trade deficit. The purpose of this article is to discuss what macroeconomic effects the import tariffs might have.

Raised import tariffs in the United States can affect both the domestic and the global economy. Compared with the import tariffs introduced during the previous Trump administration, the current proposal entails much higher tariffs and covers more countries. This indicates that the effects of higher import tariffs will have greater effect this time. However, there is considerable uncertainty over how much the import tariffs will be raised.

US companies may benefit in the short term from reduced foreign competition, with positive effects on production and employment. Additionally, more Americans may purchase domestically-produced goods rather than imported goods to a greater extent. In addition, increased income from tariffs can be used to stimulate the economy or improve public finances. However, there are also a number of negative

[17] The trade barriers included both raised tariffs and other trade barriers. See Global Trade Alert, https://www.globaltradealert.org/global_dynamics

effects. US companies that are dependent on imported input goods will experience higher costs, which will make these companies less competitive.

The experiences from earlier episodes of raised import tariffs show that the shift from foreign to domestic production tends to result in a counteracting exchange rate strengthening.[18] A stronger dollar will hamper exports, but make imports cheaper. Higher import tariffs can also lead to disruptions in global value chains.[19] For instance, higher costs for companies affected by higher import tariffs will also lead to higher costs for both domestic and foreign companies, as they are dependent on input goods from the companies facing higher import tariffs. Increased uncertainty regarding trading can also hamper both imports and investment.

Higher import tariffs lead to higher consumer prices for US households. When companies' costs increase as a result of the imported input goods becoming more expensive, the companies pass on at least some of their cost increases to consumers. A study found that US consumer prices became 0.3 per cent higher as a result of the higher import tariffs in 2018 and 2019.[20] Several studies show that the price impact on the consumer segment of the higher US import tariffs on Chinese goods differed substantially between products.[21] One explanation for this was that some companies took the opportunity to raise their prices as a result of their improved competitive situation. Other companies, on the other hand, were more likely to reduce their profit margins.

Higher consumer prices mean that households' purchasing power declines, which reduces their opportunities to consume other goods and services, which in turn has negative effects on growth. The higher inflation can also affect households' and companies' inflation expectations and affect the US central bank's policy rate. Both model analyses and empirical studies show that higher import tariffs lead to lower GDP in both the short and long term and higher inflation in the short term in the country raising tariffs. Studies that have analysed the effects of the United States' raised import tariffs in 2018 and 2019 reach similar conclusions.

Studies that have analysed the effects of Trump's proposal regarding higher import tariffs being implemented show that GDP growth in the United States would slow

[18] See, for example, L. Boer and M. Rieth (2024), "The Macroeconomic Consequences of Import tariffs and Trade Policy Uncertainty", *IMF Working paper* 24/13 and M. Obstfeld (2016), "Tariffs Do More Harm Than Good at Home", IMF Blog, International Monetary Fund.

[19] A global value chain is a process that describes the different steps required to produce a product or service, where each step is spread across different countries or regions in the world. This covers everything from product development, design, manufacturing and distribution to marketing and sales.

[20] See M. Amiti, S.J. Redding and D.E. Weinstein (2019), "The Impact of the 2018 Tariffs on Prices and Welfare", *Journal of International Perspectives* 33(4):187-210.

[21] See, for instance, A. Cavallo, G. Gopinath, B. Neiman and J. Tang (2021), "Tariff Pass-Through at the Border and at the Store: Evidence from US Trade Policy", *American Economic Review*: Insights 3(1):19-34 and A. Flaaen and J.R. Pierce (2019), "Disentangling the Effects of the 2018-2019 Tariffs on Globally Connected U.S. Manufacturing Sector", *Working Paper*, Finance Economic Discussion Series 2019-086, Board of Governors Federal Reserve System, Washington DC.

down in both the short and long term. Inflation in the United States could be 1 percentage point higher during at least one year after the tariffs were raised.[22] The negative effects on GDP and inflation would be much greater if other countries choose to respond by raising import tariffs on US goods.

The Swedish economy would also be affected. Higher US import tariffs on goods from all foreign countries would slow down global economic activity and have negative effects on the Swedish economy. The size of the negative effects on the Swedish economy would depend, for instance, on the scope of the trade with the United States, and on whether or not the EU chose to raise import tariffs on US goods. A recent study shows that the negative effects would be greatest for the United States' neighbouring countries Mexico and Canada, which export a lot to the States, while the negative effects on Europe would be moderate.[23]

The Swedish economy has become increasingly dependent on exports abroad. The United States is one of Sweden's most important trading partners, and exports of goods to the States comprised 9 per cent of total goods exports in 2023. Exports of services to the United States have grown rapidly and currently account for 43 per cent of total exports to the United States. With regard to employment, the United States is the country where Swedish exports employ most people.[24] Higher import tariffs on Swedish goods would also to some extent entail lower exports of services to the United States but mainly impact Swedish exports of goods. Import tariffs would make Swedish goods more expensive in the United States and affect their competitiveness in relation to goods produced in the States. Reduced demand for Swedish goods would lead to lower export income in industries with large exports to the United States, such as motor vehicles, machines and pharmaceuticals. The effect on the Swedish economy also depends on how households and companies are affected by the higher import tariffs. Increased uncertainty and pessimism could hold back both household consumption and corporate investment.

It is uncertain what effect higher US import tariffs would have on Swedish inflation. There are factors indicating both lower and higher inflation. Lower resource utilisation resulting from lower Swedish and global GDP indicates lower inflationary pressures. Weaker global demand could also dampen inflation via lower world market prices for commodities. If the United States raises import tariffs substantially on Chinese goods, China may instead try to export more to Europe. This could lead to China cutting prices on its export goods, which could slow down inflation in Sweden. Whether or not the EU would take measures to prevent lower Chinese import prices is uncertain. What points to higher inflation is that higher US import tariffs lead to increased costs

[22] See, for instance, W. McKibbin, M. Hogan and M. Noland (2024), "The International Economic Implications of a Second Trump Presidency", Peterson Institute for International Economics, *Working Paper* 24-20. In the scenario it is assumed that the United States raises import tariffs on Chinese goods by 60 percentage points and tariffs on all goods from other countries by ten percentage points. It is further assumed that all countries raise their import tariffs on US goods by the same amount as the United States has raised tariffs.

[23] See footnote 22.

[24] See report from the Stockholm Chamber of Commerce (2024), "Sverige och USA - starka band i en orolig tid" (Sweden and the United States - strong ties in uneasy times). During 2020, 135,000 people were employed in producing goods and services that were exported to the United States. This corresponds to a share of total employment of 3 per cent.

on imported input goods for US companies. This will probably lead to Swedish imports of US goods becoming more expensive. Imports from other countries where US input goods are used may also become more expensive. The extent to which import prices rise will also depend on how the krona develops. If the demand for Swedish exports falls significantly, the krona could weaken. Increased global uncertainty could weaken the krona further.

To summarise, increased trade barriers hamper global economic activity. This leads to higher costs for households and companies, especially in the country that has raised import tariffs. Trade barriers hamper trade and limit competition, the pace of innovation and the opportunities to benefit from economies of scale. This ultimately leads to lower productivity and GDP than would otherwise have been the case.