EconoFact Chats – Tariffs: Jobs, Prices, and Retaliation
Kimberly Clausing, UCLA School of Law
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I'm Michael Klein, Executive Editor of EconoFact, a non-partisan web-based publication of the Fletcher School at Tufts University. At EconoFact, we bring key facts and incisive analysis to the national debate on economic and social policies, publishing work from leading economists across the country. You can learn more about us and see our work at www.econofact.org.

Michael Klein
Tariffs are taxes. You won't hear politicians calling for higher taxes, but you also won't hear politicians declaring ‘no new tariffs.’ In fact, just the opposite. Both Democratic and Republican politicians have kept tariffs in place or even suggested raising them. This appeals to certain interest groups, and perhaps more broadly to nationalist sentiment. But what does economics have to say about the effects of these taxes? To answer that question, I'm very pleased to welcome back to EconoFact Chats, Professor Kimberly Clausing. Kim is the Eric M. Zolt Professor of Tax Law and Policy at the UCLA School of Law. She is an economist and a nationally recognized expert on tax policy. She is a co-author with Mary Lovely of a new policy brief published by the Peterson Institute for International Economics entitled, ‘Why Trump's Tariff Proposals Would Harm Working Americans.’ This work published last month is already influential, and its analysis has been cited in, among other places, The Wall Street Journal, The Washington Post, The Atlantic, and CNN. Kim, welcome back to EconoFact Chats.

Kimberly Clausing
Thanks, Michael. It's always a pleasure to talk with you.

Michael Klein
Well, it's always great to talk with you too, Kim. There are a number of issues that economists focus on when analyzing taxes. Revenue generation, effects on economic efficiency, who pays the tax, and how these payments differ across various income groups. I'm going to ask you about each of these in turn. First, tariffs were a major source of government revenues before the institution of the income tax towards the beginning of the 20th century. At that time, government spending was a much smaller proportion of overall economic activity than it is today, correct?

Kimberly Clausing
That's right. Tariffs were a major source of government revenue, but governments were smaller then. If you look at the 1800s, tariffs were nearly all federal revenue, and they were in the neighborhood of half of federal revenue at the advent of the income tax. The income tax wasn't really in place until a constitutional amendment allowed it in 1913, and after that, the income tax
became far more important. I think what caused the income tax was in part, a concern that tariffs weren't a particularly fair way to raise government revenue.

**Michael Klein**
The situation now, of course, is very different. How much do tariff revenues contribute to the government's coffers today?

**Kimberly Clausing**
Today, it's still less than 2% of GDP. It was about 1% of GDP before the Trump rounds of tariffs in the last part of last decade, but still very tiny compared to the income tax or the payroll tax.

**Michael Klein**
They're pretty tiny, but candidate Trump proposes reducing the reliance on income taxes and instead raising revenues through tariffs. Is that realistic?

**Kimberly Clausing**
Yeah, I mean he has run on a similar promise before and executed both large income tax cuts and big increases in tariffs in his first term. What he's suggesting now is quite a bit larger. He suggested more than $4 trillion in income taxes over 10 years, income tax cuts, sorry, over 10 years, and the largest increase in tariffs that we've seen since Smoot-Hawley, that was a set of tariffs that helped cause the Great Depression, a 10% across the board tariff on every trading partner as well as 60% tariffs on the entirety of our trade from China. I think that's part of why looking back to history is important because he's suggesting doing the opposite of what happened in 1913, reducing the role of the income tax while in parallel increasing the role of tariffs.

**Michael Klein**
In fact, Smoot-Hawley is a pejorative term among economists now, isn't it?

**Kimberly Clausing**
Yes, for good reason.

**Michael Klein**
That brings me to the second point, who pays for tariffs? You quote Donald Trump who claims that foreigners pay tariffs, presumably through getting a lower price than they would if imports were not taxed. So basic microeconomics tells us that's not accurate, correct?

**Kimberly Clausing**
That's right. If you look at standard economic analysis, when you put a tariff in a market, it raises the price to buyers in that market. There is one caveat, sometimes large countries can drive down
world prices, but the evidence in this particular case is quite clear. There have been about a
dozen studies of the Trump tariffs and in every instance, we see that U.S. buyers of imports paid
higher prices to the amount of the full tariff, so the U.S. consumers and buyers were the ones
bearing the burden of that cost. Of course, domestic producers got protected. They could raise
their prices too. That's something that Mary and I in our study don't actually measure, but it's
another big cost to consumers is the fact that not only are the imports getting more expensive, but
the goods that compete with them get more expensive as well. Then of course, the government
raises some revenue from the tariff.

**Michael Klein**

In the work that you did with Mary, you also talk about what economists call ‘deadweight loss.’
Can you describe what this means and how tariffs generate deadweight loss?

**Kimberly Clausing**

Yes. Deadweight loss is the idea that someone is losing and no one is gaining in parallel. If you
think about the case for trade in general, economists often refer to the gains from trade, which is
sort of the opposite situation where when you trade with another country, the total amount of
gain is exceeding the amounts lost. So, in this case, when you restrict trade, you lose some of
those gains from trade, and if you add up all the losses to consumers, they're bigger than the
gains to government in the form of revenue or the gains to producers. That's because tariffs cause
two kinds of inefficiency. One, they encourage domestic producers to make things that they
aren't otherwise suited to making, and that pulls resources away from other sectors of the
economy where we may have more of a comparative advantage. Second, consumers are
sometimes priced out of markets that they'd like to participate in. That's also a cause of
inefficiency. If I'd like to buy a foreign dishwasher, but now I can't afford one at all, that's
another sign of inefficiency and deadweight loss.

**Michael Klein**

You talked about the gains from trade, and when economists use that term, they're talking about
the aggregate gains for the economy as a whole. But the costs and benefits of trade fall
differently on different segments of society. In particular, do poor people tend to pay a higher
proportion of their income than richer people when tariffs are imposed?

**Kimberly Clausing**

Yes, that's definitely true. I think the most important reason why that's true is because savings
patterns are very different throughout the income distribution. If you think about a poor
household in the bottom quintile, they're going to be spending almost all of their income. Some
poor people even spend in excess of their income. Whereas if you look at a richer person at the
top of the income distribution, they might be saving large fractions of their income. And so
whenever you get consumption varying relative to income, which is what I just described, any
consumption tax is going to burden those who are consuming all of their income more than it burdens those who are saving a big chunk of their income. There's some data in the paper where we kind of show this by decile, but you get this very clear pattern that poor and middle-income households are consuming more traded goods than higher income households. That's partly just because they're consuming more. A second reason is that we might think even within consumption bundles that there may be more traded goods for lower income households. The evidence there is a little more mixed. Some studies show that that's true. Some studies show a more even pattern, but there have been studies that certainly suggest that poor households are more sensitive to price increases and more harmed by price increases. That's both logical and exactly what would happen in the case of tariffs because those price increases would be more harmful to those at the bottom of the distribution. In our analysis, we show really clear regressive effects from this tariff experiment. If Trump were able to follow through on his plan to have a 10% across the board tariff on every imported good as well as a 60% tariff on the Chinese goods, the tariff cost alone for the poorest quintile would be over 4% of their income, but for those in the top 1%, this would be less than 1% of their income for the reasons that we just discussed.

Michael Klein
We've been talking about consumption, but another stated motivation for tariffs has to do with production, in particular to preserve or create jobs. But, a problem with that argument is that tariffs are often on things that are used in production like steel, making it more expensive for domestic companies that use steel, and that can lead to job losses in other industries, say washing machines or cars. What's the evidence on that?

Kimberly Clausing
There's a lot of clear, compelling evidence from the first round of the Trump tariffs that they didn't lead to any promised job creation. In fact, they were quite harmful in that they generated shocks, both for the supply chain reasons that you just alluded to, but also because of retaliation. One study I believe has actually been featured on your EconoFact website, which is a study from Kadee Russ and Lydia Cox, and they look at the steel example that you just described, and they find that steel tariffs cost 75,000 jobs in industries that use steel, but only generate about 1,000 jobs for the steel workers. If you look at U.S. steel employment, it's been relatively flat. There's no evidence of big gains there, but if you're making something like cutlery or machinery that uses steel, you're going to have a big disadvantage, and that's exactly what that study shows. More generally, there's been a number of studies following up on the first round of Trump tariffs, hopefully the only round, but following up on the ones that he levied between the beginning of his administration and the end, and you see that in general, there were new shocks associated with the retaliation, there were new shocks associated with supply chain disruption, and on that the job effects were harmful, not helpful, and one of these studies was even penned by the authors of the China Shock literature, which some of your listeners are probably well aware of, but it showed that there were some job losses due to China's entry into the WTO, but they find
that those kinds of shocks, you can't go back in time by putting on tariffs, you're just going to create new shocks, and that's exactly what they show in their research.

**Michael Klein**

Yeah, we just posted an interview with Gordon Hanson, one of the co-authors, along with David Dorn and David Autor of the China Shock, and he does address that, and the memo that we have by Kadee and Lydia is actually one of our most read memos, and really has gained a lot of attention. Kim, you also started to talk about the idea of retaliation. Can you describe what that means, and whether or not we've seen it, and what its effects would be?

**Kimberly Clausing**

Yeah, so we definitely saw retaliation due to the Trump tariffs. China responded immediately with like tariffs on U.S. products, and what we saw was that the U.S. exporters lost market share in a pretty permanent way with respect to China. For instance, soybean farmers were displaced by Brazilian soybean farmers, and those markets just sort of disappeared to U.S. farmers. So retaliation is a really important issue. In the case of the farmer example, that meant the Trump administration had to spend a lot of their tariff revenues just on payments to farmers, and the farmers themselves would have much preferred to keep those markets than to receive the handout. So not only is there a fiscal cost associated with responding to those harmed by retaliation, but there's, you know, a larger cost to export industries and workers in export industries as they face those threats. If we imagine putting a tariff on every trading partner of the United States, you know, that's going to cause enormous retaliation throughout the world. Even our closest friends are certainly not going to sit idly by while we take that action, and we also saw that in the case of Trump tariffs. When he levied tariffs on Europe, for instance, in steel and aluminum, Europe responded by putting tariffs on things like Kentucky whisky, and that immediately started hitting the sellers of those products. So, I think that's a very important angle to remember, and it's important not just in its economic effects in terms of thinking about the export industries and the export workers, but it's also important when we think about international relations. You know, we're in a time where there's enormous problems in the world that we're trying to resolve, where climate change is a really pressing global phenomena, where public health issues could still arise, and so getting along with partners, friends, and other trading partners is extremely important as opposed to alienating the whole world with one swoop.

**Michael Klein**

Yeah, in that tariff war between the United States and China, the Chinese government at one point promised to purchase an additional $200 billion of American products, but ultimately they didn't follow through with that.

**Kimberly Clausing**

That's right. It was a stunningly ineffective policy in almost any policy goal measure that you
might look at. My Peterson colleague, Chad Bown, who's now on leave at the U.S. State Department, but he tracks on the Peterson website the various stages of that conflict and shows almost no effectiveness in terms of increased Chinese imports. There's also no effectiveness in terms of driving down the overall U.S. trade deficit, in terms of changing Chinese behavior, in terms of U.S. job creation, so it's really hard to identify any positive thing that came from that policy.

**Michael Klein**

So we've laid out the arguments that economists draw on when making the case against tariffs, but what about protecting through tariffs industries that are seen to be vital for national defense or to ensure an adequate supply of vital goods, like face masks if we face another pandemic?

**Kimberly Clausing**

Yes, so here we should probably distinguish two issues. One is reliance or dependence on any key country, especially if that country might prove to be an adversary, and I suppose if we wanted to be a little more generous to the Trump China tariffs, we could point out that it did cause some delinking from China, and so if we thought we were overly dependent on one country, there was some delinking that occurred as trade got displaced to other countries such as Vietnam. So, an example of a national security issue is we wouldn't want to be dependent on Russia right now for any particular product because right now Russia is engaged in a war with one of our key allies, Ukraine, and so it would be unwise for us to be too dependent on an adversary, right? And it's also...there are concerns about over reliance in China. But that's a very different thing, those concerns, from saying that we should produce every particular good in the United States. So as an example, if we're worried about access to things like face masks in your question, then we should make sure that there's a diversity of sources, whether they're domestic or foreign, that we can purchase face masks from, right? And if we think that there's key supply chain hurdles with respect to semiconductors, we should make sure that there's multiple sources of semiconductors. So producing domestically is less important than making sure that the source is diverse enough that we can have resilient response to shocks. Now the one thing we might want to make sure to produce domestically would be things that we think are just so central to national security that we really need to control them. So we might think weapons could fit that criteria, but it's not the case that everything that Americans enjoy consuming needs to be produced at home. We should just make sure that we have access to a diversity of sources, and there's lots of ways to do that, and some of those mean expanding trade with partners and friends through vehicles like the Indo-Pacific Economic Forum or other collaborations where we might be able to encourage more trade rather than less.

**Michael Klein**

So we've been talking a lot about the tariffs put in place by President Trump, but President Biden hasn't really removed those, as I alluded to in the introduction. And in fact, in May, President
Biden announced new tariffs on Chinese imports, including electric cars, solar panels, steel, and aluminum. The administration makes the argument that restricting trade on Chinese electric vehicles and solar panels will help spur American industry to become competitive in these areas that are vital for addressing climate change. This is a form of what economists call the infant industry argument for trade restrictions. Can you describe what that argument is and whether or not it makes sense in this context?

Kimberly Clausing
So the basic idea of the infant industry argument is that sometimes there might be a producer that's naturally the low-cost producer in the world, but they can't get up to scale because at the early stages of production, they're going to be too small to compete with other producers in the world. So, unless you give them kind of a window of protection, they won't be able to expand to be large enough to be competitive, even though they might have naturally been competitive. So we suspect that we would see things like that for industries that have learning effects and scale effects and where there might be capital market imperfections such that we can't expect private markets to kind of wait for those industries to be successful. I think the argument with respect to electric cars, solar panels, steel and aluminum is somewhat different from that argument in the sense that those sectors aren't particularly new. We've already kind of moved down cost curves in terms of scale in many of those sectors. I think the argument here is somewhat different, which is that the U.S. taxpayers are encouraging investments in those industries and therefore they expect to see some U.S. job creation, right? And if we invest taxpayer money in those industries and then they fail in world competitive lens, then we might feel like that wasn't a good investment. So, they've certainly made arguments that are akin to the infant industry argument implying that this will be temporary, but I think in some cases, like electric cars, that argument might be stronger than in other cases like steel and aluminum. We've had steel and aluminum for a long time. I don't expect a temporary protection to really help in that area, whereas with respect to nascent industries, you might think that's a more reasonable thing.

One more distinction, since you've asked about this question, it sort of sounds to many like President Biden's proposals are akin to the Trumpian proposals, and I would just point out right off the bat that they're very different in scale. So, whether or not we think these new tariffs on Chinese imports are wise, they affect about $18 billion worth of U.S. imports. The scale of what candidate Trump has suggested is $3 trillion. So if you compare the number $3 trillion to $18 billion, we're really talking about more than 150 times the protection in terms of the tax base that would be affected from the Trump tariffs than from these smaller Biden measures. So I think the scale is vastly different. I'm not a huge fan of either set of proposals, but if I had to pick one, I'd pick the more narrow targeted and strategic one.
**Michael Klein**

So Kim, given all these arguments, if you were made U.S. Trade Representative, what would you advocate for trade policy?

**Kimberly Clausing**

So I think a number one thing is sort of similar to what doctors vow in medicine, which is do no harm. I would avoid putting tariffs on without thinking about it very carefully, without having a very good strategic, thoughtful reason for doing that. I would work to revitalize the rules-based trading system, which certainly needs some reforms, and I've done some work with Chad Bown suggesting some ways to modernize WTO rules, but certainly the rules-based system has worked really well. And so, I would work with other countries to try to reform that system so that we can stay within it rather than just violating the rules when they don't suit our interests. Second, I think it's also really important to encourage freer trade, and that's essential to several of our aims, including security aims, including responding to climate change. If you look at the current structure of tariffs throughout the world, it's disproportionately encouraging fossil fuel industries relative to clean industries because protection levels are actually quite a bit lower in fossil fuel related industries than they are in clean energy. That's something we should work with our trading partners throughout the world to reverse, right? We should have freer trade in clean energy goods than we do in fossil fuels, and that's another thing that we could push for together with partners throughout the world, and that's something that really the whole world should be able to get behind. I think it's really important for the U.S. to be able to offer other countries something in exchange for the kinds of things that we value, and I think expanding trade and market access with countries throughout Asia, for instance, is something that we have done too little of. I think the Trans-Pacific Partnership would have been an excellent step in that direction, and I think backing away from that was a historic mistake. I think relying on IPEF to expand trade with Asia is relatively modest in comparison, and the trade tier of that has been less successful, so I would work towards more collaboration with other countries to increase trade towards the aim of enhancing, ultimately, economic security and responses to these global challenges like climate change.

**Michael Klein**

Well, Kim, I would actually be pleased if you were, in fact, named the next U.S. Trade Representative, although it seems like a much higher stress job than being a law school professor, and also it would mean that you couldn't join me as a guest on EconoFact Chats while serving in that role, so maybe it's just as well you're not going to be the next U.S. Trade Representative, and if the offer comes you might want to think long and hard before accepting it. So, thanks for speaking with me today, Kim, and covering this really important topic in such good detail.
Kimberly Clausing
Thank you so much. It's always a pleasure to be with you on these chats.

Michael Klein
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