THE WALL STREET JOURNAL.
The Wall Street Journal, January 28, 2025

How Much Do Tariffs Matter?

Their economic effect is minimal, but reordering the world-trade system would be dangerous.

By Donald L. Luskin

Donald Trump's promise to impose tariffs on imports of foreign goods and services was a pillar of his campaign rhetoric. He has already brandished tariffs against Mexico, Canada and Colombia, but those were only threats to achieve political objectives such as cooperation on immigration. In the flurry of executive orders he issued on his first day in office, all he did regarding tariffs as a tool for rebalancing America's trade relationships with other nations was call for a study of the matter. That should be easy, because a quick survey of history reveals the potential risks and rewards if he goes forward with this policy.

As a starting point, we know that tariffs are tax hikes. They're inherently small tax hikes because tariffs only apply to, at most, a base of $3.257 trillion—the total value of goods and services the U.S. imports annually. The personal income tax applies to a much larger $25.079 trillion base. That means a 10% tariff would have an effect roughly equivalent to a 1.3-point increase in personal tax rates.

Therefore tariffs wouldn't be a significant revenue source for the Treasury. Before January 2018, when Mr. Trump announced the first in a series of tariff initiatives that would roll out over the coming two years, tariffs were bringing in a trivial 1.1% of federal tax revenue. Mr. Trump's tariffs started producing revenues for the Treasury in July 2018. Over the year that followed, tariff collections rose to 2% of federal tax revenue—about double the pretariff percentage, but still trivial in the grand scheme of things. In his 2020 campaign, Joe Biden promised to repeal Mr. Trump's tariffs, but as president he failed to do so and even added his own. Today, tariffs bring in 1.7% of federal revenue.

The first Trump term's tariffs offer economists a natural experiment. We can analyze what difference the tariffs made over the 20-month period from their imposition in July 2018 to February 2020, shortly before the pandemic upended everything.

Did the tariffs raise inflation? No. Consumer Price Index inflation averaged 2.1% over the initial 20 months of Mr. Trump's tariffs, nearly identical to the 2.2% of the prior 20 months. Market participants are worried that the Federal Reserve is already keeping policy tighter than it otherwise would for fear of the inflationary effects of coming tariffs. That would be a policy error based on the historical record, which shows that unfounded fear of tariffs would be more harmful than the tariffs themselves.

Did the tariffs affect economic growth? No. Real gross domestic product growth averaged 2.7% at an annual rate over the initial 20 months of Mr. Trump's tariffs, including both the best and worst non-pandemic quarters of his presidency. That's nearly identical to the 2.9% of the prior 20 months.

Most crucially, did tariffs affect the trade deficit? Their main purpose was to reduce it. Sadly, no. Over the initial 20 months of Mr. Trump's tariffs, the trade deficit as a share of GDP averaged 2.2%, the same as in the prior 20 months. Today, with the combined Trump and Biden tariffs in place, the trade deficit is higher, at 2.5% of GDP.

So why bother imposing tariffs? And conversely, if they have little effect, why all the angst about them? Perhaps Mr. Trump's proposals have raised concerns because they're only part of the president's broader program to reconfigure the long-established order of global trade with America as the hub and the U.S. dollar as the world's reserve currency. Granted, Mr. Trump has committed to maintain dollar supremacy; he has even threatened tariffs against any nation that doesn't honor it. But based on the people he surrounds himself with, he appears willing to upset the global-trade apple cart.

He has selected economist Stephen Miran to be chairman of his Council of Economic Advisers. Writing as a strategist for hedge fund Hudson Bay Capital in November, Mr. Miran argued for tariffs, capital controls, taxation of foreign investments in U.S. securities, dollar devaluation—and even exploring the sale of U.S. gold reserves. Mr. Miran calls this plan "restructuring the global trading system."

Vice President JD Vance has said the U.S. dollar's reserve-currency status has contributed to persistent trade deficits and artificially low borrowing costs that have hollowed out America's manufacturing base and left us a debtor nation. Mr. Vance suggests we may be better off without it.

But U.S. manufacturing jobs bottomed out in 2010—eight years before Mr. Trump's tariffs—and have been rising ever since except for a blip during the pandemic.

And among the Group of Seven nations, the U.S. is tied with the U.K. for the highest borrowing costs on long-term sovereign debt—and that's with reserve currency status. Do we dare find out what our borrowing costs would be without it?

Recent attempts to tweak the global trade system haven't hurt, but they also haven't helped. That system isn't ideal, but Messrs. Trump, Vance and Miran should respect that it has evolved over the entire postwar period. It has been the platform for multigenerational global prosperity and the advance of liberty. Surely further tweaks are at our peril—"restructuring" even more so—with likely little to no upside.

The Trump administration should instead focus on policies we know will make a positive difference: dealing with our borrowing costs by reducing debts and deficits, and maintaining growth by preserving and expanding the expiring provisions of the 2017 Tax Cuts and Jobs Act.

Mr. Luskin is chief investment officer of TrendMacro.