SECTION VI: TARIFFS AND ECONOMIC QUESTIONS

CHAPTER 14

Trump 2.0's Tariff Policy and Its Effect on the US Domestic Economy

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Introduction

Global macroeconomic management principally hinges on monetary and fiscal policy. The effectiveness of these policies, and their resultant implications for economic variables such as prices, employment and profits, largely depend on the prevailing economic conditions. This study is inspired by the fiscal policies implemented in response to the tariff measures of the Trump administration. The central question is how tariff-induced restrictions on foreign goods will affect economic conditions, such as employment, inflation, foreign direct investment, income inequality and exports. According to Clausing and Obstfeld (2024), Trump aims to use the revenue from tariffs to cut income tax, with the projected US$780 billion from tariffs designated for tax reductions on income and investment by the same amount. Clearly, this was meant to lift some tax burdens from corporations and individuals. However, Clausing and Obstfeld (2024) show that only the rich will benefit from this policy, while the bottom 80% of the population, based on income distribution, will lose.

For example, how will Trump's planned income tax adjustments, based on the proceeds from higher tariffs, impact US inflation rates, given the retaliatory stances of countries like China, and the high landing costs of raw materials?

According to Gallo (2015), determining the appropriate price for a product or service is a herculean task. Also, one of the critical factors in pricing is clarity about price elasticity. The modelled tariff proposals by the Budget Lab raise between $1.2 to $4.4 trillion over a decade given conventional assumption. Retaliation by other countries against US tariffs reduces US tariff revenue in relation to the same proposal in a situation of no-retaliation by 12-26%. The Budget Lab computed that the tariffs at first increase the level of consumer prices by 1.2 to 5.1% (Budget Lab 2024). There is a likelihood that Trump's tariff policies worsen the wider capitalist crisis (Siddiqui 2025), accelerating inflation and amplifying trade wars – disproportionately affecting the Global South (Siddiqui 2023).

Accordingly, this chapter examines the implications of Trump's tariffs on the US economy. However, there is inadequate data to quantify the macroeconomic effects of recent United States tariff policy announcements. Moreover, Trump's tariffs and their economic implications are still unfolding. Consequently, this study provides some insights into the potential implications of this policy based on historical data over the last three decades (1991— 2023). The next section examines the arguments around the economic implications of tariff policy.

Drivers and implications of tariff policy

In the view of the US administration, the tariffs aim at multiple goals such as stimulating re-industrialisation, generating revenue, and reducing trade deficits with several trading partners (Alschner et al. 2025). Current studies in economics have extensively examined tariffs as tools for welfare redistribution, trade protection, and political economy, with particular emphasis on the U.S.-China trade conflict from 2018 to 2020 (Jagwani 2026).

A study by Hong, (2025) considered a range of trade theories such as Mercantilism and its Critique, the Theory of Comparative Advantage, Heckscher-Ohlin Theory. Also documented are the prisoner's dilemma, Strategic Interactions in Trade Negotiations, and terms–of–trade theory. The author observed some major theoretical insights, among which is that trade-offs exist between short- and long-term effects, while tariffs only potentially provide transient relief to certain industries but cause long-term costs that exceed short-term advantages (Krugman et al. 2018). Based on the theoretical and empirical considerations presented in Hong, (2025), the author inferred that tariffs are mostly ineffective

in realising policy goals. There have not been significant reductions in trade deficits, generating considerable costs on downstream industries and consumers, resulting in more job losses than gains, and causing retaliatory measures which adversely affected export-oriented sectors (Fajgelbaum et al. 2020; Flaaen and Pierce 2019; Morgan et al. 2022).

For instance, based on the infant industry argument, the unfettered entry of an established international firm into a country could make it difficult for a local start-up firm to prosper (Johnson 2013; Saure 2007). Strategic trade theory shows that in some oligopolistic, high-tech and defence-related industries, tariffs are useful in supporting local firms against foreign competitors, mostly in instances of significant learning-by-doing and economies of scale (Brander Spencer 1985; Das 2021). These and other arguments provide a sound basis for the application of tariffs, although little attention is paid to their sustainability, given the possible impact they may have on other macroeconomic variables and consequently the welfare of households.

In considering the evolution of economic theory and trade, scholars observe that the impacts of tariffs are not immediately observable and that their effects on economic variables are only revealed over time (Pal 2025; Lavergne 2014; O'Rourke 2000). Tariffs influence GDP and price levels, as, according to economic theory, they decrease trade volumes and drive up domestic prices (Krugman and Obstfeld 2009). Blanchard (2017) argues that tariffs might affect output and aggregate demand, but stresses that these impacts do not occur instantaneously. It was observed that reciprocal retaliation causes net welfare losses for the United States' economy (Ignatenko et al. 2025). Therefore, it is important for the United States to have an exploratory overview of the behaviour and performance of its macroeconomic variables over time in order to assess the pros and cons of its tariff policy.

Descriptive evaluation of historical data

The attempt to examine the previous behavioural pattern of major macroeconomic variables resulted in the collection of data sets which spanned 1991 to 2023. The macroeconomic variables include gross domestic product per capita (lgdppc) and patent application, resident (lpar), which were translated by a logarithmic transformation. Other variables in their base form include import value of goods

(impv), export value of goods (expv), inflation (inf), foreign direct investment (fdi), unemployment rate (une) and inequality as measured by Gini coefficient. All the variables were obtained from the World Development Indicators. However, the missing data points on tariff rates for 1994 and 2023 were obtained through interpolation. Also, the inequality measured by the Gini coefficient had a missing data point for 2023, which was obtained through interpolation. Moreover, patent applications, residents, import values and export values have missing data points for 2023 and were obtained through interpolation.

Table 1 shows that the logarithm of gross domestic product per capita is negatively skewed over the data span, with a value of -0.107, which is approximately normally distributed. The negative skewness is an indication of possible weak productivity in the United States over the periods under consideration. Also, import value is approximately normally distributed with a skewness of 0.403. Export value has a skewness of 0.5, foreign direct investment has a skewness of 0.64, the unemployment rate has a skewness of 0.778 and inequality has a skewness of -0.514. The negative skewness of inequality is an indication of relatively fewer incidences of unequal income distribution in the United States as a developed economy. The positive skewness of export value also shows that the country has been making giant strides in domestic production and the export of goods. However, import value, characterised by positive skewness, implies that over time the United States has come to depend on the importation of raw materials for domestic production or of finished goods. Moreover, the United States has been favourable for foreign direct investment considering its positive skewness.

Table 14.1: Descriptive statistics. Source: Authors' computation from Stata 19.

Variables	Obs	Mean	Std. Dev.	Min	Max	p1	p99	Skew.	Kurt.
Lgdppc	33	4.648	.146	4.386	4.918	4.386	4.918	-.107	2.071
Tariff	33	2.232	.813	1.55	4.25	1.55	4.25	1.444	3.83
Impv	33	77.36	37.342	22.896	172.422	22.896	172.422	.403	2.678
Expv	33	75.535	33.86	31.433	160.593	31.433	160.593	.5	2.409
Lpar	33	5.29	.168	4.944	5.47	4.944	5.47	-.739	2.182
Inf	33	2.609	1.457	-.356	8.003	-.356	8.003	1.272	7.219
Fdi	33	1.603	.742	.465	3.406	.465	3.406	.64	2.88
Une	33	5.773	1.66	3.638	9.633	3.638	9.633	.778	2.738
Ine	33	40.552	.896	38	42.9	38	42.9	-.514	4.964

Table 14. 2: Pairwise correlations. Source: Author's computation from Stata 19.

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
(1) lgdppc	1.000								
(2) tariff	-0.851***	1.000							
	(0.000)								
(3) impv	0.975***	-0.777***	1.000						
	(0.000)	(0.000)							
(4) expv	0.952***	-0.717***	0.985***	1.000					
	(0.000)	(0.000)	(0.000)						
(5) lpar	0.926***	-0.922***	0.859***	0.834***	1.000				
	(0.000)	(0.000)	(0.000)	(0.000)					
(6) inf	0.083	0.084	0.217	0.172	-0.155	1.000			
	(0.645)	(0.642)	(0.225)	(0.338)	(0.391)				
(7) fdi	0.238	-0.466***	0.197	0.172	0.343	-0.063	1.000		
	(0.182)	(0.006)	(0.271)	(0.338)	(0.051)	(0.727)			
(8) une	-0.179	0.140	-0.190	-0.140	-0.055	-0.358**	-0.381**	1.000	
	(0.319)	(0.436)	(0.289)	(0.437)	(0.763)	(0.041)	(0.029)		
(9) ine	0.679***	-0.656***	0.691***	0.665***	0.662***	-0.017	0.232	-0.394**	1.000
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.925)	(0.194)	(0.023)	
*** $p<0.01$, ** $p<0.05$									

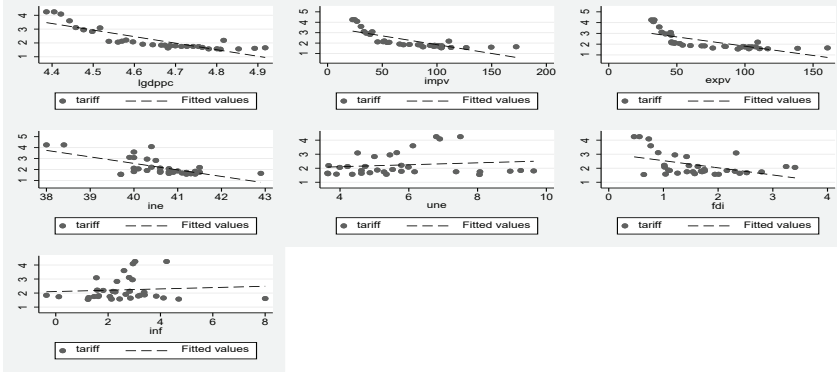

Figure 14.1: Scatter plots. Source: Authors' computation based on WDI database.

Table 14.2 provides information on the degree of correlation among the variables. The data show that GDP per capita and tariff are significantly and negatively correlated (-0.851), indicating that they move in opposite directions simultaneously. However, import value and export value are characterised by a significant direct association with GDP per capita at 0.975 and 0.952, respectively. Patent applications also have a significant direct association with GDP per capita (0.926). The table also shows that inequality has a degree of association of 0.679 with GDP per capita. The second column of Table 14.2 shows the variables that are significantly related to tariffs. These include import value (-0.777), export value (-0.717), patent application (-0.922), foreign direct investment (-0.466) and inequality (-0.656). The common observation among these variables is that they are all negatively associated with the tariff rate. The third column indicates that import value has a significant direct association with export value (0.985), patent application (0.859), and inequality (0.691). The fourth column shows that export value has a significant direct association with patent application (0.834) and inequality (0.665). The fifth column shows that patent application has a significant association with inequality (0.662). The sixth column shows that the inflation rate has a significant negative association with the unemployment rate (-0.358). The findings also show that foreign direct investment has a significantly negative association with the unemployment rate (-0.381), while unemployment has a significant negative association with inequality (-0.394).

Figure 14.1 shows the respective scatter plots with specific consideration for the tariff rate. It provides a visual demonstration of the extent of clustering of the tariff rates around some of the variables as well as confirming the sign and the degree of associations. The outcome shows over time that GDP per capita had a high degree of clustering around tariff rates. The same conclusion goes for import values, export values and inequality. However, unemployment rates, foreign direct investment and inflation rates, although showing some clustering, are far dispersed from some tariff rates.

The new Trump tariff policy and relevant insights

One of the major frontline issues of the current Trump administration is tariff policy, which influences key macroeconomic variables, along with the direction of trade in the United States, the affected economies and the global economy in

general. What are the possible outcomes of key macroeconomic variables in this context, considering previous trends? Despite the inadequacy of data to quantify the extent of impact of the recent tariff policies on key macroeconomic variables in the United States, some insights can be drawn on possible outcomes.

Based on a study by Giesecke and Waschik (2025), the recent US tariffs exert a negative effect on real US GDP in every scenario, such that, if there is no retaliation, the real GDP loss averages -1.3% over the simulation period. It was observed that in the short run, it indicates a negative deviation in employment (-1.5 in 2025). However, in the long run, there is a reflection of a negative deviation in the country's capital stock (-2.0 per cent in 2040) as a result of the negative deviation in the real GDP. While Giesecke and Waschik (2025) worked on simulated data, an attempt was made in the current study to observe historical descriptive patterns. For instance, the scatter plots of Figure 14.1 show that GDP per capita moved in the downward direction around tariff rates. This is an indication of declining output and standard of living over the selected periods. However, while this does not show a cause-and-effect relationship, it does provide information on the Trump administration's capacity to evaluate and prevent the current tariff policy from undermining US productivity and standard of living.

Notably, import and export values both trended in a negative direction over the study period. Building on these previous outcomes, how might the US respond to the retaliatory stance by its major trading partners like China and Canada? China has had a considerable increase in export volume to and trade surpluses with ASEAN countries, along with Africa, South Asia and Latin America in recent years (Tran 2025). Such a magnitude of trade with countries other than the United States indicates that China has considerable stamina for retaliation. This may have a pronounced impact on the import and export values of Figure 14.1, scattered around the tariff rates of the United States in the negative direction.

Another dimension to the potential impact of this development is the negative correlation between tariff rates and income inequality. As evident from the historical data above, a decline in tariff rates is accompanied by a decline in inequality rates. This historical pattern should therefore guide the United States government in its tariff policies. The following figures provide a graphic illustration of the US relationship between inequality and tariff rates over time. The two graphs indicate that inequality, though fluctuating, trended in an upward

direction. The specific effect cannot be concluded, as the exact cause-and-effect relationship was not examined through a regression model.

The Congressional Budget Office's projections indicate that real consumer spending rises by 1.8% in 2026, which is also the rate it increased in 2025. Moreover, numerous other factors constrain spending, including tariff-related price increases, resulting in the continued depletion of purchasing power, alongside weaker population growth stemming from lower net immigration. Higher prices for goods due to tariffs subsequently affect spending patterns by shifting the composition of consumer spending away from goods and towards services (CBO 2026).

According to Russ (2019), estimates from two studies show that the cost of tariffs imposed in 2018 and the first half of 2019, comprising both deadweight loss and direct burden, amounts to about $800 per household. Therefore, it can be implied that the burdens would reduce the real value of household incomes, which could exacerbate income inequality. Figure 14.2 shows that income inequality in the United States has been unstable over the 1991—2023 period and has fluctuated in an upward direction despite downward-trending tariff rates (Figure 14.3). The implication, therefore, is that tariff rate adjustment must be done in conjunction with appropriate monetary policies, such as interest rates, which influence credit conditions in the United States.

The base argument, therefore, revolves around how Trump's tariff policy, along with the retaliatory measures taken by the US trading partners, influences macroeconomic variables in the United States. According to Bouët, Sall and Zheng (2025), China and the United States are the most influenced economies, with losses in GDP of -1.3% for both economies in 2030. Mexico and Canada are the only economies that show a rise in GDP of 6.6% and 1.3%, respectively.

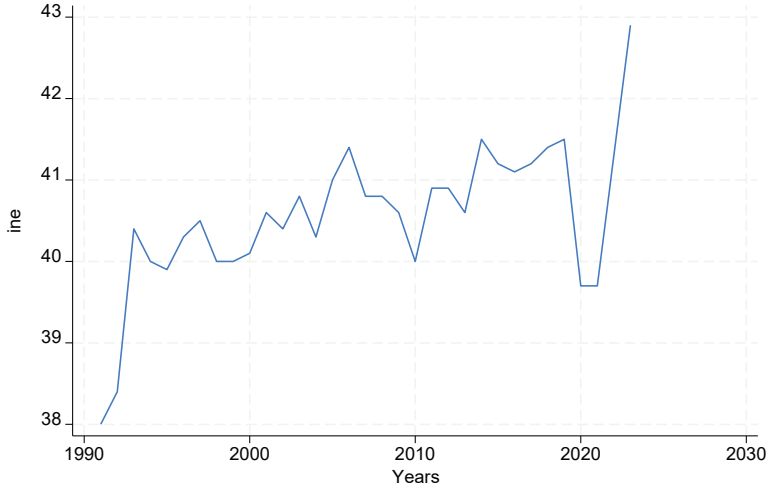

Figure 14.2: Income inequality in the United States over the period 1991 – 2023. Source: Authors' computation based on the WDI database.

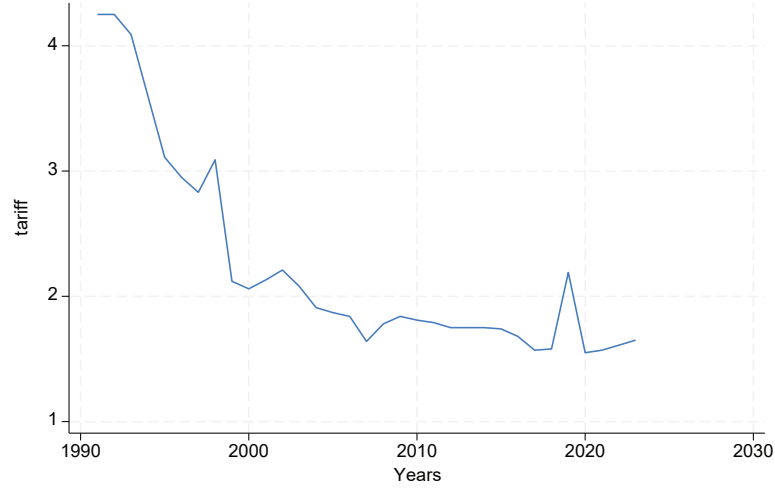

Figure 14.3: Tariff rates in the United States over the period 1991 – 2023. Source: Authors' computation based on the WDI database.

Other trends of the United States macroeconomic variables show export value and import value trending upward from 1991 to 2023. These two graphs show the vital role of the external sector in the United States economy. Foreign policy measures, such as the proposed tariffs, can therefore have a profound effect on the balance of trade. The similar upward-trending import and export values are an indication that the US should therefore be ready for disruptions to its trade balance because of retaliatory measures of its tariff policy from its trading partners.

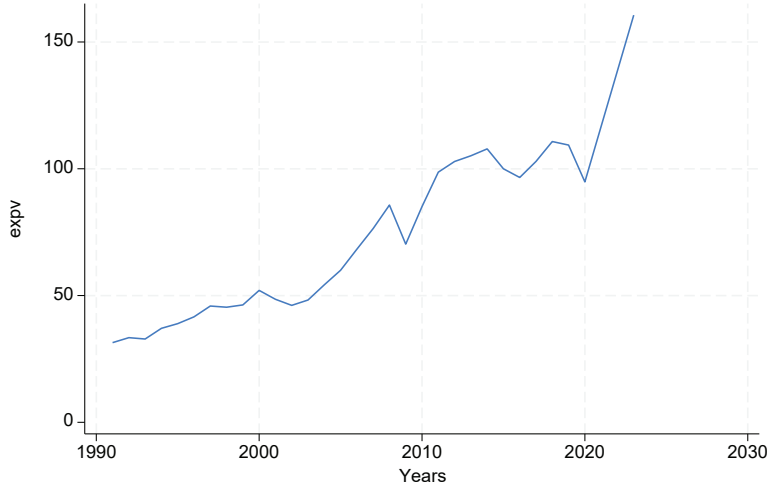

Figure 14.4: Export value in the United States over the period 1991 – 2023. Source: Authors' computation based on WDI database.

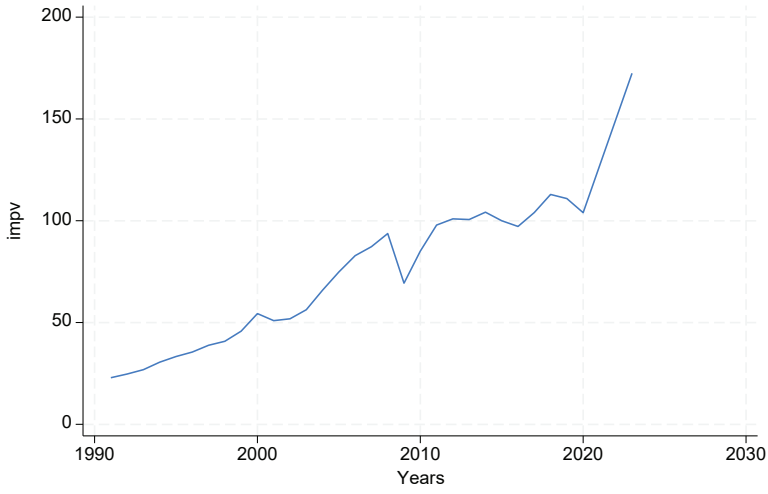

Figure 14.5: Import value in the United States over the period 1991 – 2023. Source: Authors' computation based on WDI data base.

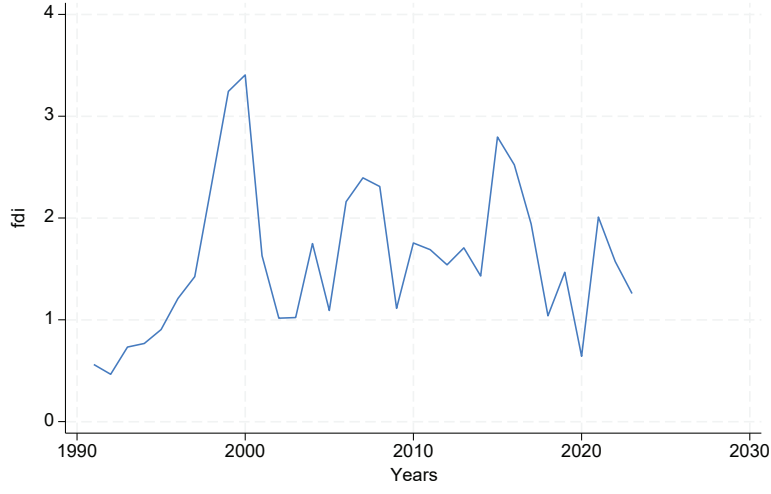

Figure 14.6: Foreign direct investment in the United States over the period 1991 – 2023. Source: Authors' computation based on the WDI database.

Figure 14.6 above provides information on the behaviour of foreign direct investment in the United States for the period 1991 to 2023. The data produced an unstable pattern. This calls for prudence in choosing a foreign policy that will foster a stable environment for direct investment. Several factors could influence the inflow of foreign direct investment, such as the macroeconomic environment, which is largely driven by fiscal and monetary policies. Retaliatory tariffs could negatively affect the cost of raw materials and raise production costs. This could also have consequences for future investments, and may subsequently have a negative effect on output, employment, income distribution and standard of living. Caution is therefore called for when implementing a tariff policy. For instance, according to Hung (2025), the International Chamber of Commerce has admonished that the tariff war 'risks sinking the world in new depression'.

Conclusion

This study could not offer empirical evidence of the exact impact of Trump's tariff policy on various macroeconomic variables in the United States, because of a lack of available data. However, it examines the previous behaviour of certain key macroeconomic variables descriptively in order to provide some cautions on the proposed and already implemented tariff policy. The impact of the tariff policy and the resultant trade war that might result could generate a profound effect on the trade balance of the United States. This is because it will affect the country's import value, which may raise the cost of production for domestic firms. The export value of the country historically trended upward, similar to the import value. This is a caution against distorting the country's trade relations. During the 1991 to 2023 period, income inequality fluctuated in an upward direction, while foreign direct investment lacked stability. It can therefore be surmised that the factors showing volatility in the 1991 to 2023 period may worsen if the tariff measures raise the cost of production, dampen productivity, skew employment, and redistribute income, which leads to income inequality.

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