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ECONOMY | U.S. ECONOMY

Tariffs Start to Ripple Their Way Through the U.S. Economy

Effects are like a tax increase, very small at this point, but reducing real GDP and eroding real wages



The introduction of a 20% tariff on washing-machine imports in January led to a 17% jump over three months in the portion of the consumer-price index that tracks laundry-equipment prices. PHOTO: RICHARD B. LEVINE/NEWSCOM/ZUMA PRESS

By Josh Zumbrun

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In recent weeks, several major rounds of tariffs have moved from proposals to realities, and major new tariffs have been threatened—shifting the stakes for President Donald Trump’s trade actions on the U.S. economy.

Tariffs raise the price of imported goods, increasing costs to consumers, and making domestic producers (who don't face the tariff) more competitive.

Examples of how new tariffs might ripple through the economy have already been provided by earlier, smaller rounds of tariffs. These earlier examples also show why broad effects from tariffs, on the otherwise booming U.S. economy, might be hard to detect.

One of the first to go into effect under Mr. Trump came in January, with the imposition of 20% tariffs on washing machines.

While tariffs are formally paid by whomever imports the goods, the importers can pass their costs along to consumers. In the case of washing machines, that happened quickly: The index for laundry equipment in the Labor Department's consumer-price Index, the nation's main gauge of inflation, shot up by about 17% over the past three months.

That is by far the biggest three-month gain in laundry equipment in data going back 12 years. But it comes at the end of a period in which prices had mostly declined for years. Those price declines, driven by foreign-made products, had placed domestic appliance producers under pressure to begin with.

The surge, though sharp and clearly inflationary, only put washing machine prices back to where they had been in June of 2015.

As with any major appliance, consumers don't buy them very often, and likely don't notice month-to-month price swings. Major appliances are just one-tenth of 1% of the consumer-price index.

"Certainly in some industries, or good by good, it has some material effect," said Stephen Gallagher, managing director of Société Générale. "In my view it's still not a macro event, though it could develop to that...right now it's still more of a temper tantrum on trade, as opposed to a real war."

Mr. Trump's steel and aluminum tariffs were announced March 1. For some countries they went into effect quickly. The European Union, Canada and Mexico were given more time to negotiate, but those extensions expired at the beginning of this month.

Prices for different types of steel and aluminum began to climb almost immediately, posting the biggest three-month price increase that has been recorded in years. While clearly inflationary and unwelcome for metal consumers, the jump in prices isn't that

much larger than typical volatility in the metals. And only a small portion of the metals ends up in consumer goods.

Even though a car contains several hundred pounds of aluminum, for example, auto prices haven't notably increased since the tariffs began. Car sales are down slightly, but that probably owes more to higher interest rates than to any consumer awareness of the impact of aluminum tariffs.

In public appearances, Commerce Secretary Wilbur Ross has carried around cans of Campbell Soup, holding them up and saying they have only a few pennies worth of steel in them. The effects are negative for the soup company—Campbell's stock has fallen 14% since February, and the company has cited steel tariffs specifically as something that will be a hit to its bottom line—but Mr. Ross's broader point is that most consumers won't notice.

The hit to companies like Campbell's is why the effects of the tariffs tend, overall, to reduce jobs. Far more U.S. companies consume steel than produce it. By increasing their costs and reducing their profits, the tariffs have the knock-on effect of making firms less likely to hire, economist say.

As of mid-2017, there were 29,288 steel-consuming firms, employing over 900,000 workers who face higher prices versus just 916 steel-producing firms with 80,000 employees who benefit from those higher prices and reduced competition.

Despite being a direct beneficiary of the washing-machine tariffs, Whirlpool Corp. is also a metal consumer. Its stock price jumped about 12% when the washing-machine tariffs were announced but is down 18% since. In its first-quarter earnings call in April, Whirlpool said the steel and aluminum tariffs would cost the company an extra \$50 million.

The effects are also like an inflationary tax increase, very small at this point, but reducing real gross domestic product and eroding real wages.

Those steel and aluminum tariffs are widening now that Canada, Mexico and the European Union are hit. As of last week, tariffs have also been applied to about \$50 billion of Chinese imports. Add this all up, and it's likely to be a noticeable uptick in the effective tariff rate.

Mr. Gallagher of Société Générale has estimated that the new rounds of tariffs will push the effective U.S. tariff rate, as measured by tariff revenue as a percentage of all imports, to 2% from about 1.5%.

It would be the biggest and sharpest increase in taxes on customs in well over 30 years, but it would only take trade restrictions back to where they were in the late 1990s.

Mr. Gallagher's calculations do not include the latest proposal for tariffs on as much as \$400 billion in Chinese imports, nor proposed tariffs on autos. For now, those tariffs remain just threats.

The effects remain muted because tariffs, so far, still affect only a small portion of the roughly \$3 trillion a year in imports that the U.S. is on course to bring in this year. U.S. imports are about 15% of gross domestic product, compared with a world average of 28%, according to World Bank data. In other words, despite running by far the world's largest trade deficit, the U.S. economy is less reliant on trade than most nations.

In a new analysis, Mark Zandi, chief economist of Moody's Analytics, modeled the effects of different trade policy scenarios on the overall U.S. economy.

His findings show that, in the context of a roaring economy, the negative impacts will be hard to notice.

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The tariffs announced so far would cost the economy about 145,000 jobs by the end of 2019, Mr. Zandi's analysis concluded. That is less than the total number of jobs

created in the broader economy in an average month.

If tariffs expand to \$100 billion extra of Chinese imports, as well as to other threatened goods such as autos, then the effect grows, costing the economy over a half million jobs by the end of 2019. Mr. Zandi's analysis was completed before Mr. Trump announced the possibility of tariffs on \$400 billion more of Chinese goods.

But the labor market is booming, and even under the scenario with \$100 billion in extra imports targeted for tariffs, the economy is still forecast to add about 2.5 million jobs over the next 18 months. It's just that without tariffs, it would add 3 million, in Mr. Zandi's analysis.

The basic effects of the tariff "are just like a tax increase," said Mr. Zandi, "But we had a very massive tax cut, deficit-financed, that's temporarily juicing things up this year and next year, and you're just taking some of that away."

In the scenario of expanding tariffs, GDP would be about 0.34% lower, by the end of 2019.

“It’s all negative,” Mr. Zandi said, “but right now, the dollars and cents are small in the grand scheme of things.”

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