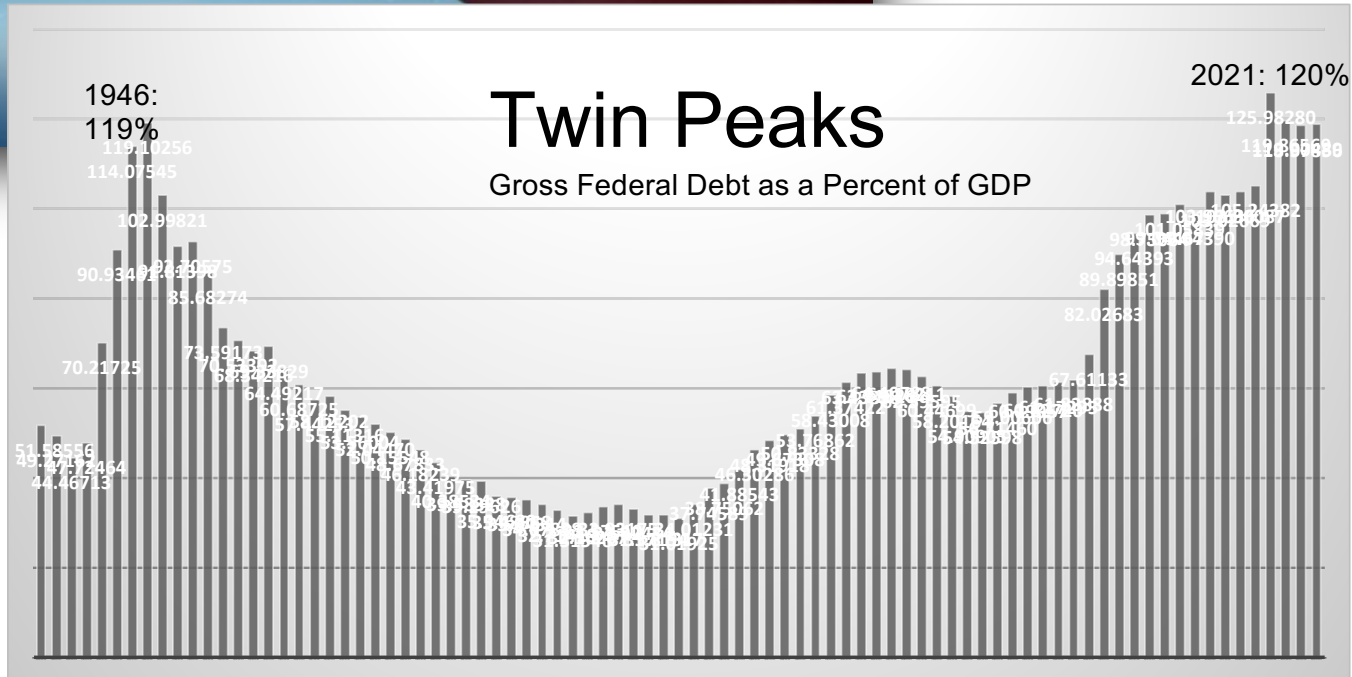




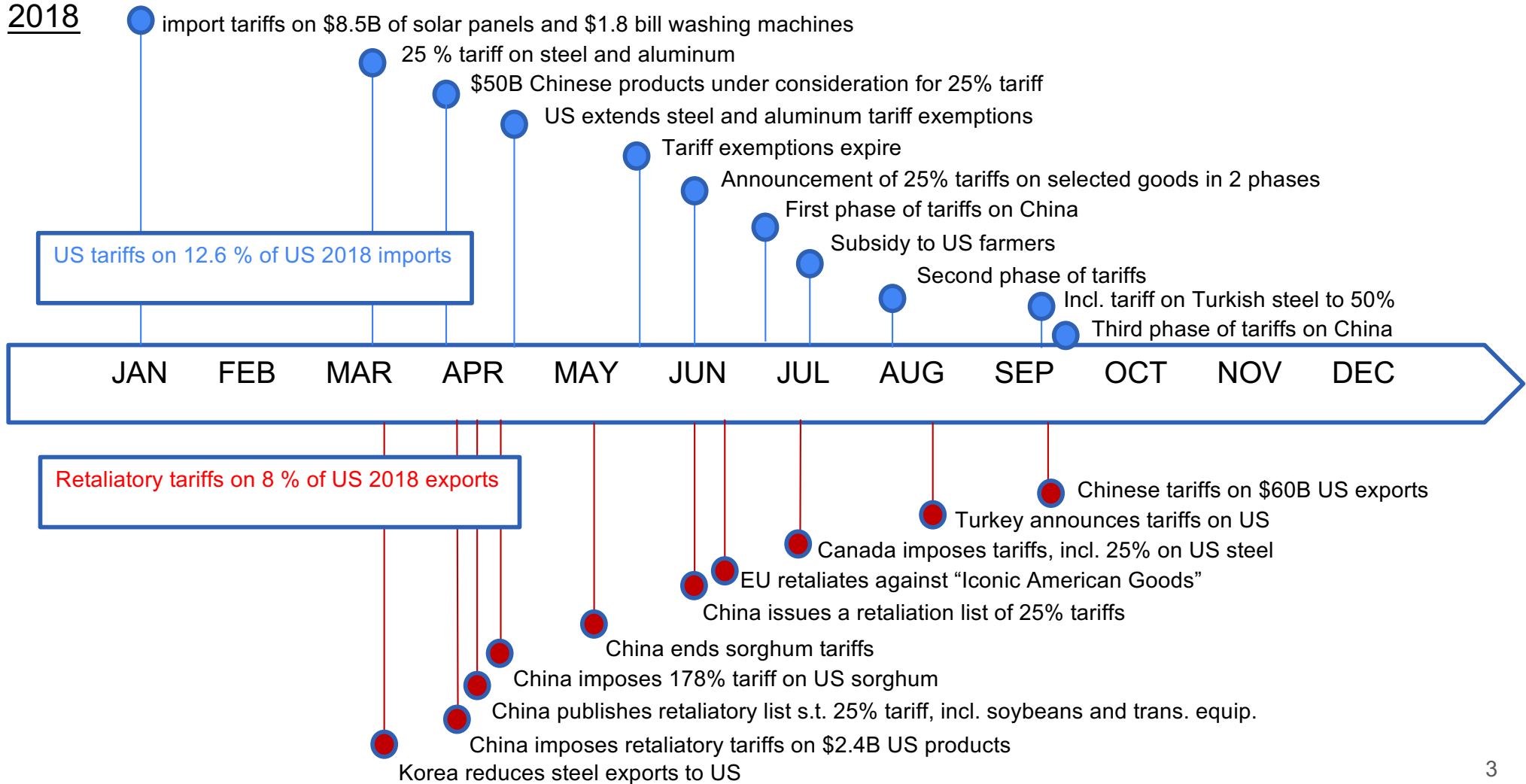
Presentation to the NY Fed Advisory Committee

Linda Tesar
University of Michigan

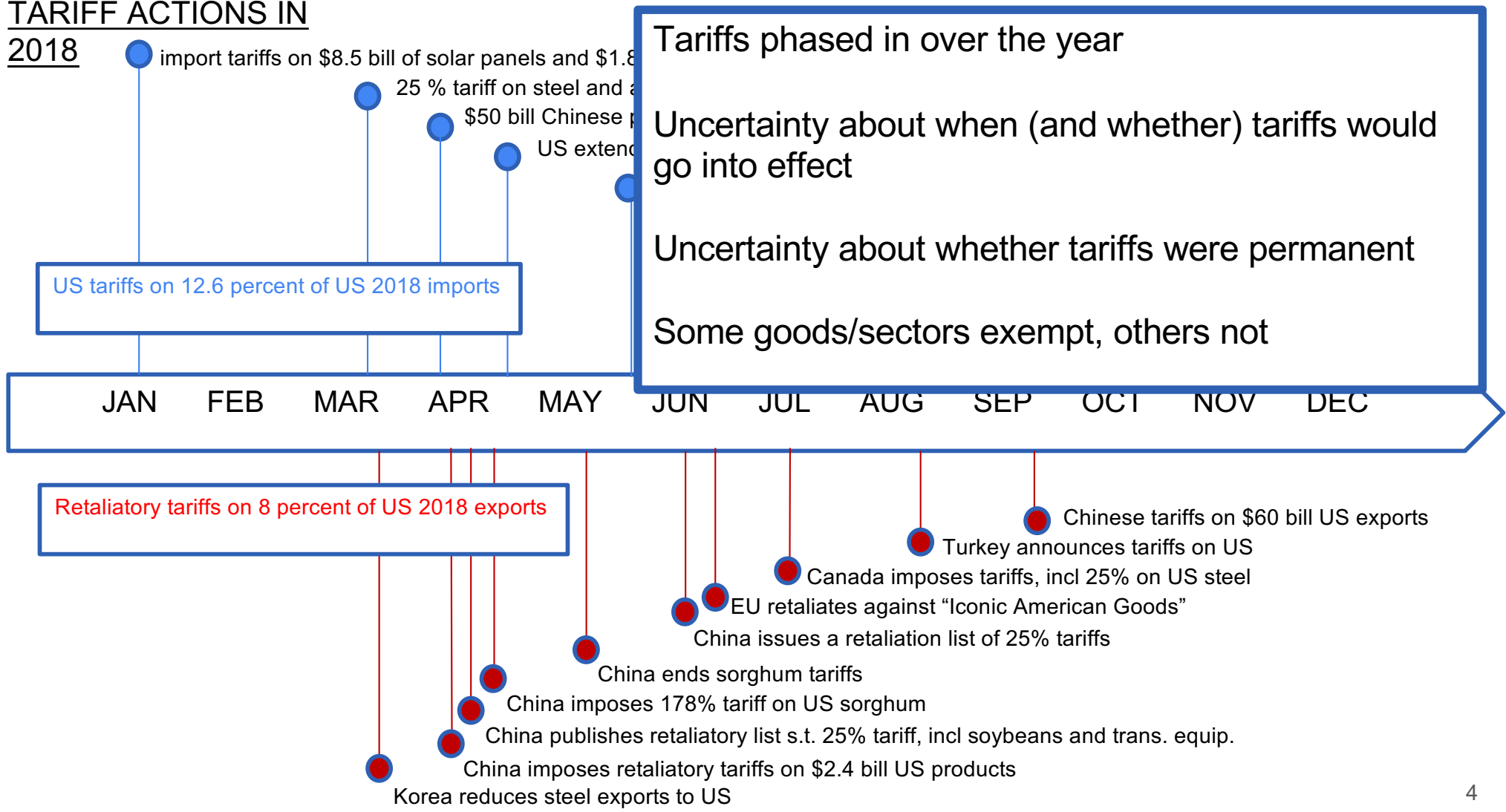
China Syndrome



TARIFF ACTIONS IN 2018



TARIFF ACTIONS IN 2018



Net impact of a trade war on economic activity

What would a naïve calculation suggest?

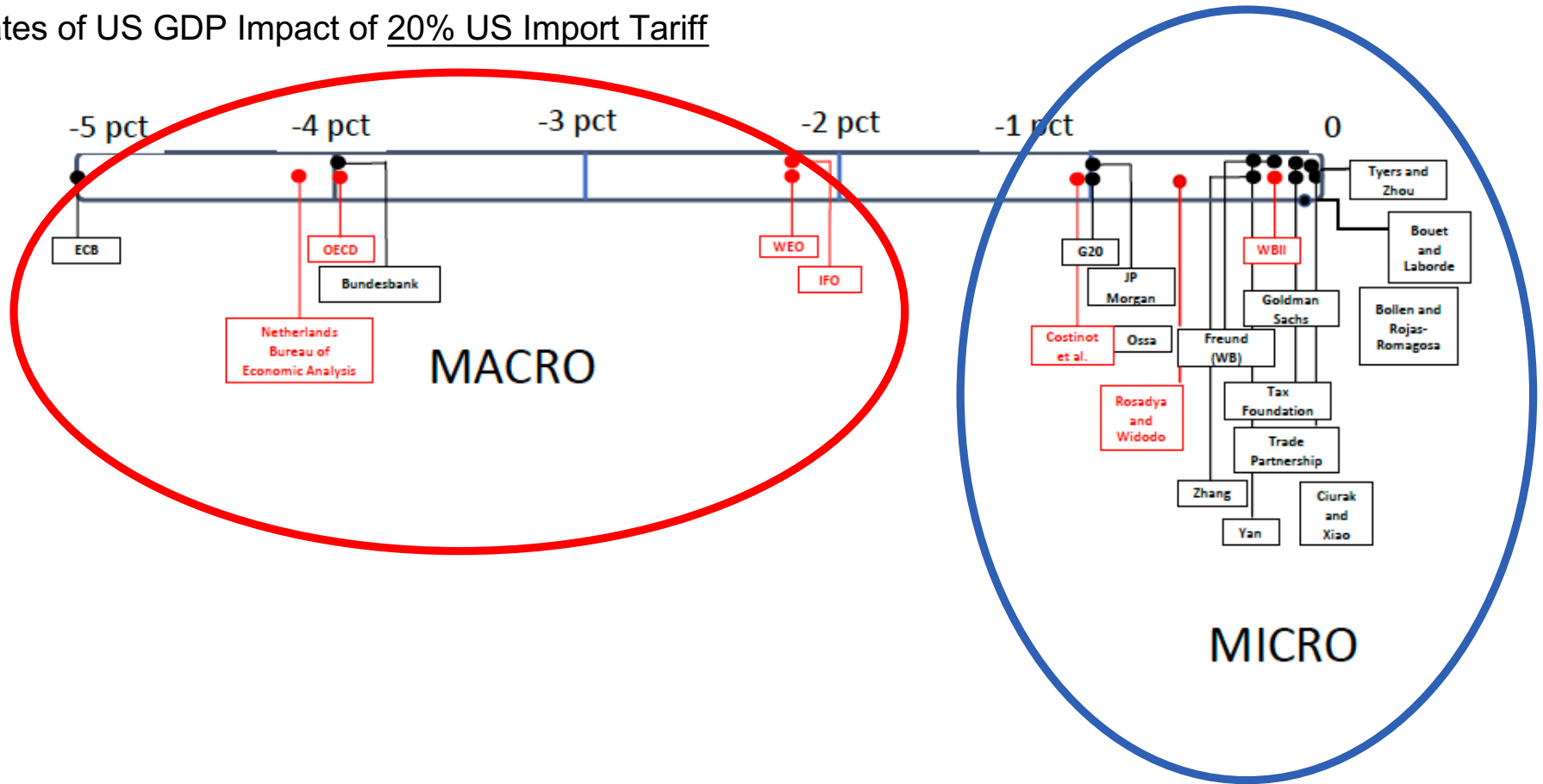
$$\text{Export / GDP} = 0.126$$

$$\text{Import / GDP} = 0.154$$

Tariff-affected trade:

$$(0.08 * 0.15) + (0.126 * 0.154) = 0.012 + 0.194 = 3 \% \text{ of GDP}$$

Estimates of US GDP Impact of 20% US Import Tariff



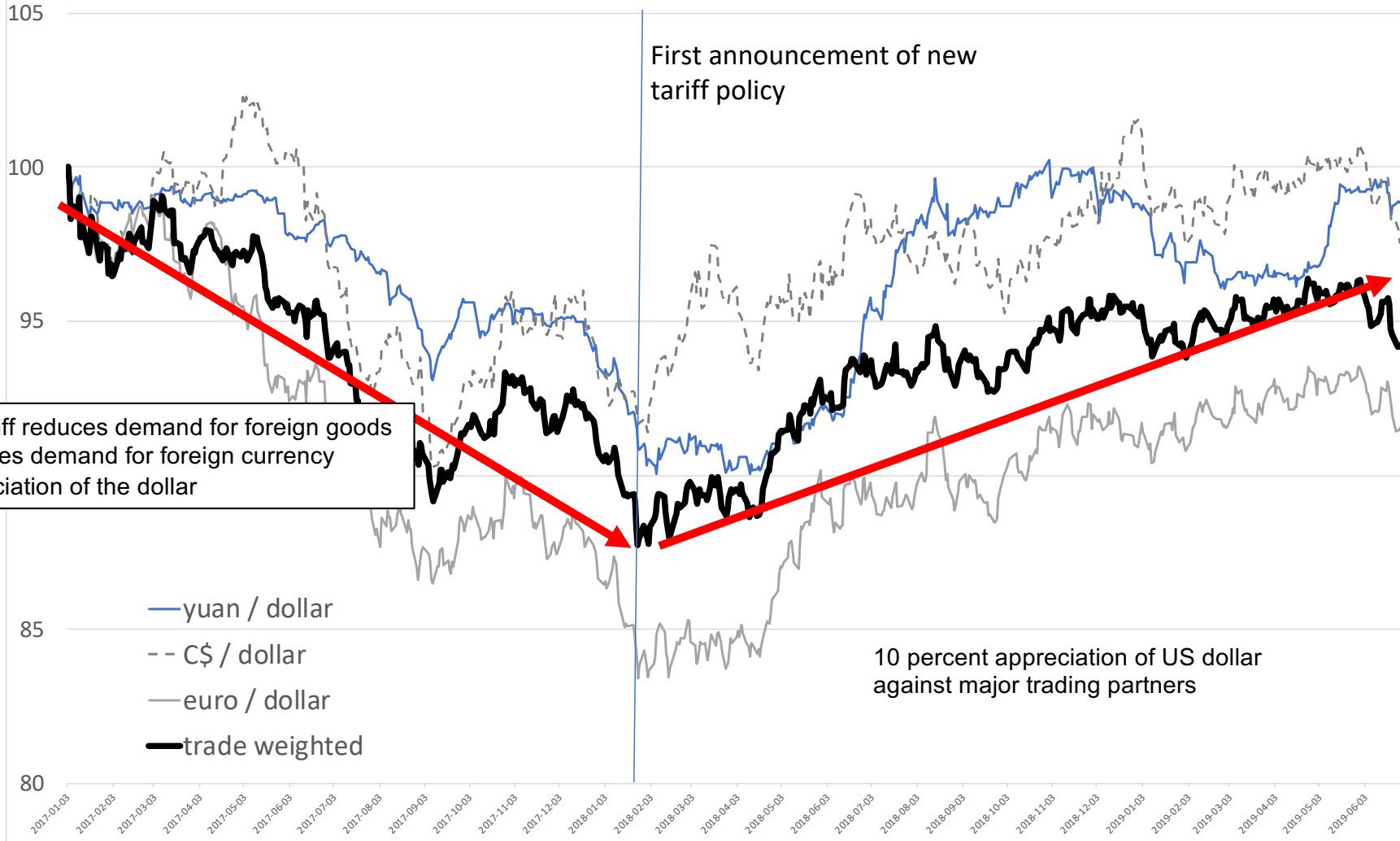
Things that make the impact of tariffs large

- Estimates based on large scale macro models (ECB, Bank of England)
 - Feedback effects through exchange rates
 - Monetary policy adjustment
 - Frictions produce unemployment
- Trade in a specific factor with no close substitutes
 - Minerals, oil, key components for production
 - E.g. Finland (Gorodnichenko et al 2012) – exported goods specific to USSR, barter exchange for oil, overvalued exchange rate, rigid labor market
- Spillovers to financial system / uncertainty
 - Decline in trade weakens banks; raises cost of capital (Handley and Limao)
- Trade affects TFP and investment
 - Imports embody knowledge
 - Trade encourages physical and/or human capital accumulation
- Investment
 - Costly transition dynamics
 - Global supply chains – provide an avenue for substitution unless the tariffs choke off multiple trading partners

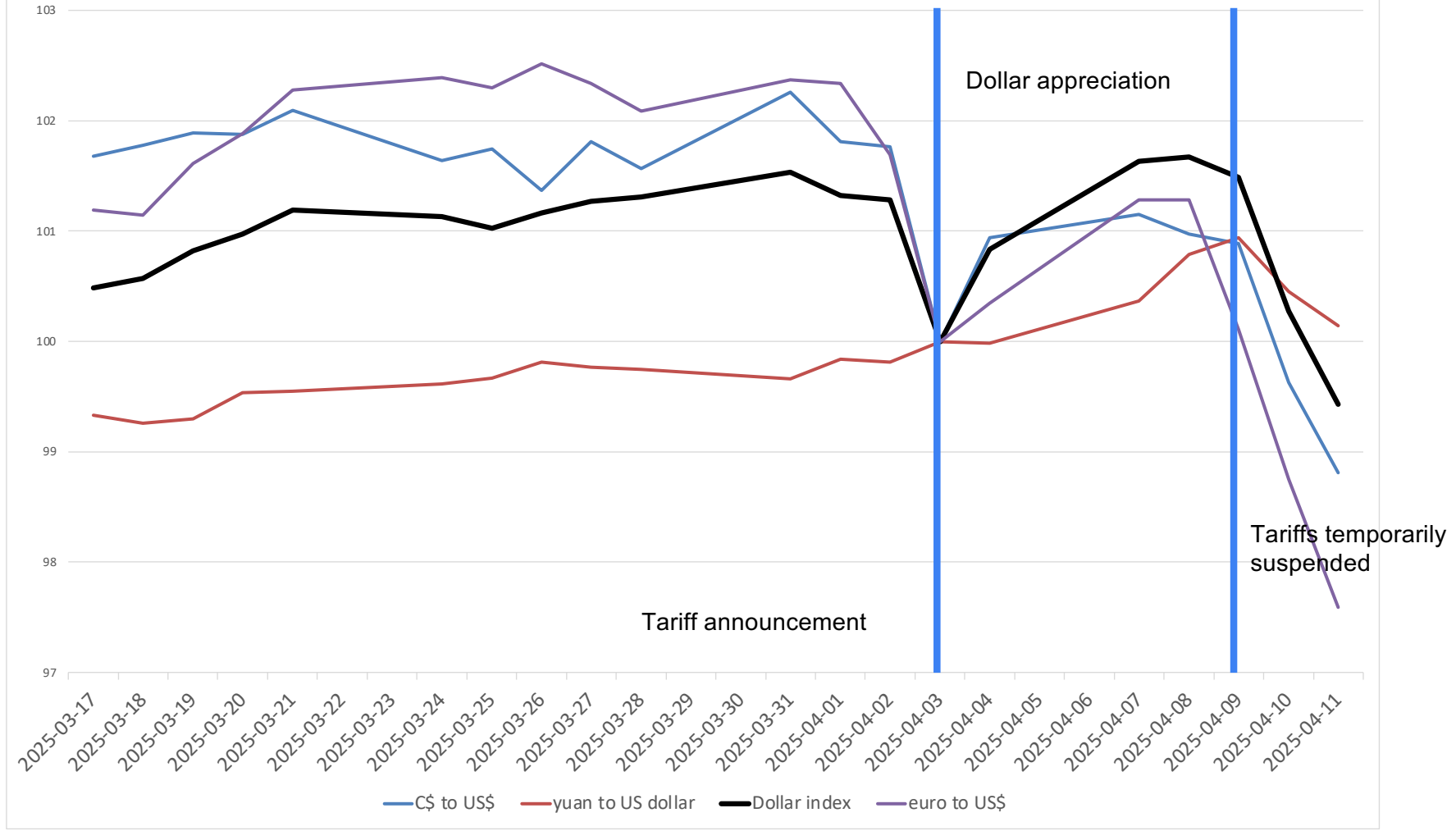
This time will be worse

- More countries involved – fewer alternative trade paths
- Cost of uncertainty
 - Delayed investment
 - Waste of human resources
- Capriciousness of the tariffs – undermines international order
- Destruction of existing global supply chains
- Side-deals – all the costs associated with inefficient carve outs

US dollar against Major Trading Partners, 2017 - 2018



US dollar against major trading partners - March -April 2025

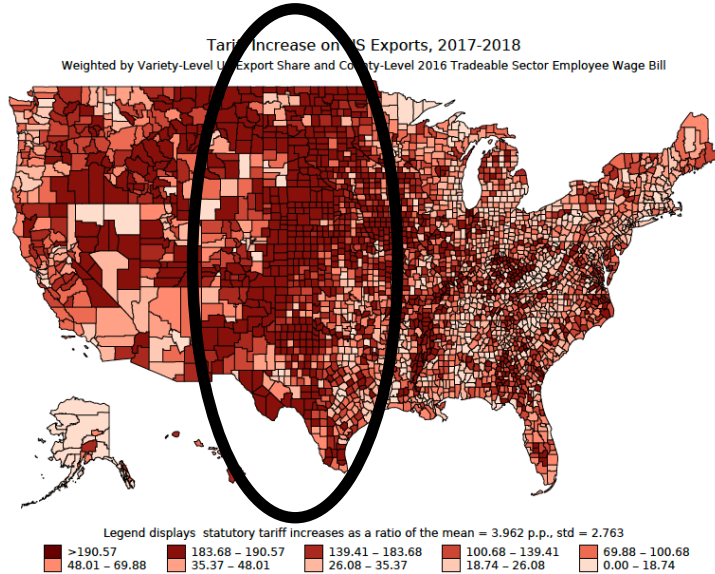


Impact of the trade war

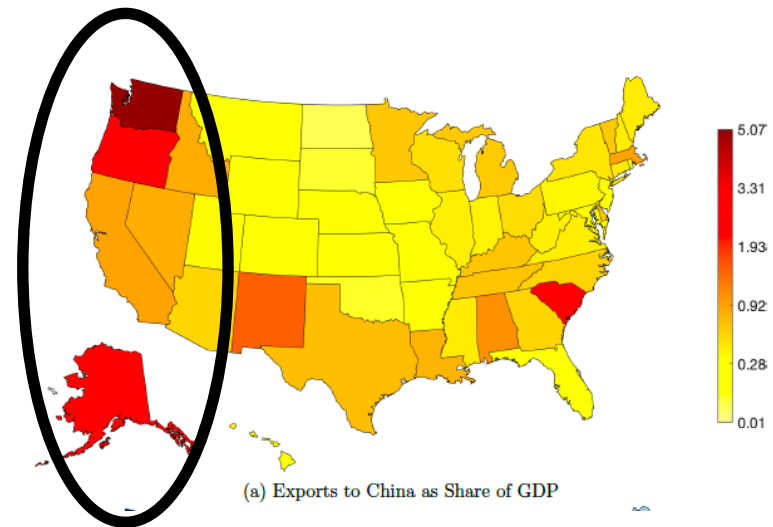
- [McKibbin & Noland \(2025\)](#) US-EU trade war (25% tariffs on all EU products).
 - result in lower rGDP for both US and EU
 - Cause a temporary inflation surge
- [McKibbin \(2025\)](#) 100% tariffs on countries that seek to reduce the US dollar's dominant role in global finance
 - US GDP is 1.6 percent lower
- [McKibbin & Noland \(2025b\)](#) Trump's proposed 25% tariffs on Canada and Mexico:
 - lower real GDP and higher inflation in all three countries
 - Initial tariffs spike inflation in all three economies
- [Yale Budget Lab \(2025\)](#) analyzes the economic implications of Trump's proposed 25% tariffs on Canada/Mexico and 10% tariff on China:
 - PCE price level increases 1 % before consumer substitution
 - Output 0.2% lower in real terms
- Kalemli-Ozcan et al - Liberation Day tariffs
 - 1.6 percent decline in US GDP
 - 0.8 percent rise in inflation
 - 4.8 percent appreciation of the dollar

Regional exposure to trade

Exposure based on employment and aggregate trade data



Exposure based on state-level bilateral trade data



Exposure to China

United States

- Extension of the TCJA will increase long run debt
- Little likelihood that tariff revenue will significantly offset the tax cut (Obstfeld 2025)
- Tax Foundation estimates
 - Debt-to-GDP ratio would increase from its long-run projected level of 201.2 % to 223.1%
 - higher interest payments on the debt reduce GNP by almost 0.8 %;
 - 20% tariff on all imports plus additionally raise the tariff on imports from China to 60% would shrink long-run economic output by about 1.3%; estimate retaliation would reduce US GDP by an additional 0.4 percent in the long run while raising no additional revenue for the US government.

Europe

- Euro area will try to position itself as the safe asset alternative to the US
- Expand trade arrangements with China
- Difficult fiscal trade off
 - Need to face rising debt while building up military capability
 - Germany new fiscal package (3/4/25) with 3 significant changes:
 - a new €500 billion infrastructure investment fund
 - an exemption from Germany's "debt brake" rule on defense spending above 1% of GDP,
 - an increase in the net borrowing cap for federal states from 0% to 0.35% of GDP.
 - Could have productivity benefits as well as limited multiplier effects



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Thank You