

# Tariff mythbusters: Alternative perspectives on American duties



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MUCH ink has been spilled about the economic cost of tariffs and the looming risk of a US recession or stagflation. We should not dismiss such concerns, but neither should we assume that these outcomes are inevitable. Challenging market assumptions can be quite rewarding, and I hope to provide alternative perspectives.

Many people assume that tariffs are inflationary. The logic seems straightforward. A 10 per cent tariff should translate into a 10 per cent price increase, all else being equal. However, that is not always the case.

Consider the case of medical gloves. Since Jan 1, 2025, the US has raised tariffs on Chinese-made medical gloves from 7.5 per cent to 50 per cent, an increase of 42.5 percentage points. Yet, glove prices have not risen in proportion to the tariff hike. That is evident from the results of Malaysian glovemakers, who should have benefited.

The reason is simple – there is an oversupply of gloves capacity globally. Supply was simply reshuffled across regions, with Chinese supply being redirected to Europe, and Malaysian supply was re-routed to the US. Malaysian players were unable to raise prices in the US by the extent of the tariffs increase, because of competition.

This example serves as a counterpoint to inflationary fears. While tariffs may drive price increases for some goods, they don't guarantee inflation across the board. Market dynamics, such as supply-demand imbalances and global competition, can significantly mitigate inflationary effects.

There is no question that a tariff is a tax. Some argue that exporters bear the brunt of the tariff burden, while others contend that it falls on consumers. Just like the parable of the blind men and the elephant, both points of view are valid. In reality, the burden is shared among exporters, importers and consumers, depending on their respective bargaining power. Thus, inevitably some portion of tariffs will be borne by consumers.

## Temporary impact

In this sense, tariffs are a consumption tax, not unlike a value-added tax (VAT) or the Goods and Services Tax (GST) in Singapore. Following this logic, the question I pose is this: How scary is a GST increase?

Singapore has raised GST by 2 percentage points over the last two years (2023-24). Yet, the economic impact has been limited. We have also seen similar consumption tax increases in countries such as Japan. At the risk of generalising, the economic impact from a GST increase seems to be temporary, with a heavy element of base effects due to demand front-loading before the GST increase and a subsequent payback period.

In other words, people tend to rush to buy more things before the GST goes up to avoid the higher taxes (demand front-loading). After the tax increase, there is a peri-

od when they reduce their spending because they would have already bought what they needed (payback period).

This temporary shift in when people buy things (before versus after a GST hike) probably accounts for most of the changes in economic figures around a GST increase (base effects). It is unlikely to be a long-term change in consumption habits.

If we look at the pre-hike and post-hike period together, there is no clear evidence that aggregate demand would be impaired. The Boston Fed estimates that a 10 per cent universal tariff and a 60 per cent tariff on China could add 2.2 percentage points to US personal consumption expenditures (PCE) inflation. Will a 2.2 per cent inflation hike cause a recession? For comparison, the US economy survived a 9 per cent inflation rate in 2022.

So, a tariff is like a consumption tax, but incurred at the border rather than at the point of sale. This is an important distinction because part of the tax increase is clearly borne by the exporter, as opposed to the consumer. This tax is captured by the government. If tariff revenues are redistributed through increased fiscal spending, the potential deadweight loss of tariffs could be mitigated or avoided.

Further, imagine this: What if US fiscal spending and deficit went up on the back of expected tariff revenues?

US President Trump has talked about reducing the fiscal deficit. But is Trump truly a fiscal hawk? He has been declared bankrupt multiple times, so it is hard to imagine



With an excess in gloves capacity, stock was simply reshuffled across regions, with Chinese supply being redirected to Europe, and Malaysian inventory was re-routed to the US.

PHOTO: REUTERS

him being a true-blue fiscal hawk.

The issue of fiscal deficit reduction was notably absent from Trump's inauguration speech. The Department of Government Efficiency, despite all the shock and awe, has not made a serious dent in fiscal spending. Furthermore, the current budget plan, with the use of the current policy baseline mechanism, does not scream fiscal prudence.

As a matter of technicality, tariff revenues do not form part of the fiscal revenue projections in the budget. But it is not hard for Trump to make the case to fiscal hawks that they should consider it nonetheless.

The pitch is simple: Instead of cost cuts, tariff revenues will help plug the fiscal deficit gap. With Trump holding the cards, he could control the timing of the trade deals and the tariff rates to orchestrate a trend of raising tariff revenues. Imagine that, as he extrapolates the "illusion" over 10 years. That could get fiscal hawks within the Republican ranks to fall in line and agree to a rather generous budget.

As a result, fiscal spending and deficit could turn out to be more than expected, which could more than offset tariff-induced econom-

ic drags. The tariff revenues may or may not come in as projected, but the fiscal spending will likely be immediate and real.

Many cite the Smoot-Hawley tariffs of 1930 as the parallel to today's trade war.

The Smoot-Hawley Tariff Act was enacted to protect American farmers and industries by significantly raising tariffs on agricultural and manufactured imports. The 1930s was also the period of the Great Depression. As such, it's not hard to make the leap of logic that today's trade war would lead to an economic recession of epic proportions.

## Context dependent

However, such an analysis is incomplete without considering the tariff increases made even earlier in 1922.

Back then, the US experienced a spike in effective tariff rates because of the Fordney-McCumber Act, which significantly raised tariffs on foreign goods. The increase in effective tariff rate was comparable to the Smoot-Hawley tariffs.

Yet, that did not lead to economic depression. In fact, the 1920s were also called the Roaring Twenties – an era of growth and prosperity, driven by post-war spending

and rapid growth in new industries such as automobiles.

The 1920s offer a clear contrast to the 1930s on the effects of tariffs. The comparison highlights that tariffs alone do not dictate economic outcome. The presence of other growth drivers, the degree of retaliation by trading partners and other factors will influence the eventual outcome. The effects of tariffs are context dependent. How would reshoring, lower energy cost and AI spending, among other things, affect current tariffs dynamics?

The trade war has disrupted the global world order as we know it. Consequently, the distribution of outcomes is wider than usual. It is not possible to explore all scenarios in a single column, but I hope this piece provides alternative perspectives and food for thought. I encourage readers to approach the trade war's impact with an open mind.

Incoming data over the next few months would yield a clearer picture of the impact and the possible trajectory ahead. Have fun investing.

The writer, CFA charterholder, is an investment professional with over 17 years of experience