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For Inflation Relief, the United States Should Look to Trade Liberalization

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Goal: 2 percentage point tariff-equivalent liberalization

- Policymakers are overlooking looking trade liberalization as a means to tame inflation, opting instead to:
    - Encourage corporate competition
    - Strengthen supply chains
    - Reduce/cap prescription drug prices.
- Relaxing tariff duties would ease price increases hitting American consumers.
- The White House should set itself a liberalization target equivalent to a 2-percentage point tariff reduction.

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$610.5 billion US imports affected by high protection

Protective policy	Approximate 2021 import value affected by high protection (billions of US dollars)
Antidumping and countervailing duties[a]	112.0
Most favored nation tariffs between 10 and 20 percent on agricultural products	1.1
Most favored nation tariff greater than 20 percent	21.2
Trump's trade war tariffs[b]	336.0
Buy America[c]	90.0
Section 232 steel tariffs	33.5
Generalized System of Preferences (GSP)	16.0
Tariffs on Moroccan potash fertilizer[d]	0.7
Total	**610.5**

Direct effect of liberalization on CPI inflation

- Imports composed roughly 12 percent of GDP and of the consumer price index (CPI) in 2021.
- Some elements of trade liberalization would directly reach consumers through lower prices at retail outlets.
- Other elements would gradually lower prices of finished goods by reducing the cost of intermediate goods.
- 2 percentage point tariff-equivalent liberalization would lower CPI inflation by 0.24 percentage point → 12 percent x 2 percentage points = 0.24 percentage point

Competitive effect of liberalization on CPI inflation

- Robinson-Thierfelder coefficient: when imports are highly interchangeable with domestically produced goods, a 1 percentage point decrease in tariff-equivalent import barriers would lead to a 0.67 percentage point reduction in CPI inflation.
- 2 percentage point tariff-equivalent liberalization would lower CPI inflation by 1.34 percentage points → 0.67 x 2 percentage points = 1.34 percentage points
  - To avoid double counting, subtract 0.24 percentage point direct effect → 1.34 percentage points – 0.24 percentage point = 1.1 percentage points

Together: 1.3 percentage point reduction in CPI

- 2 percentage point tariff-equivalent liberalization would lower CPI inflation by 1.3 percentage points → 0.2 percentage point + 1.1 percentage points = 1.3 percentage points
- 1.3 percentage point one-time decrease is not trivial, especially when CPI inflation is running at the Federal Reserve's target rate of 2 percent annually.
- As lower-income households consume a larger proportion of their income than upper-income households, trade liberalization a progressive policy.

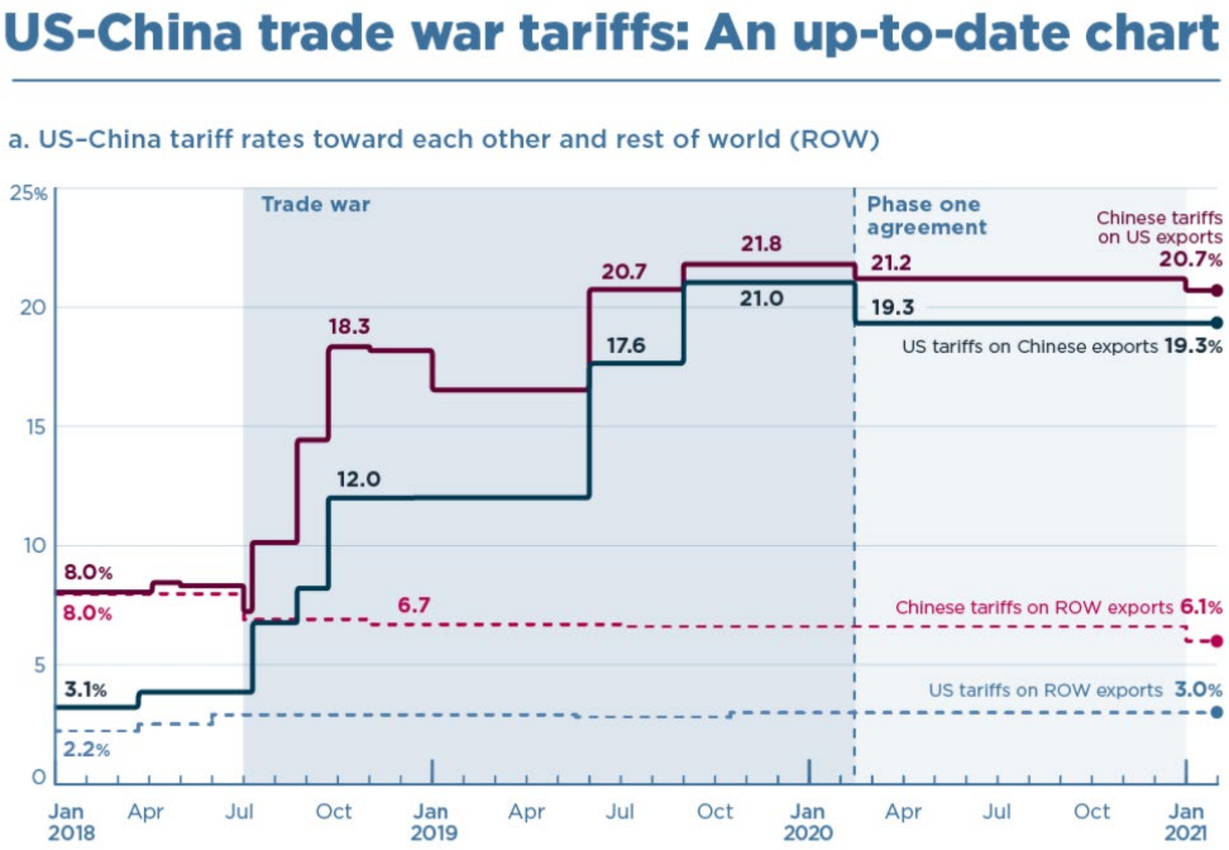
Examples of inflation relief

- Eight measures are considered.
- Below is the exercise we conducted for each measure:

Liberalization measure undertaken on certain products → **How much money can this save for US consumers?** → **How much is that saving, in terms of tariff-equivalent reduction on all US imports?** → **How much does that translate to CPI inflation reduction (direct + competitive)?**

- Note that the sensitivity of price level in response to change in tariff would differ among different products, requiring a mix of coefficients when translating tariff-equivalent reduction to CPI inflation reduction.

1. Eliminate Trump's trade war tariffs

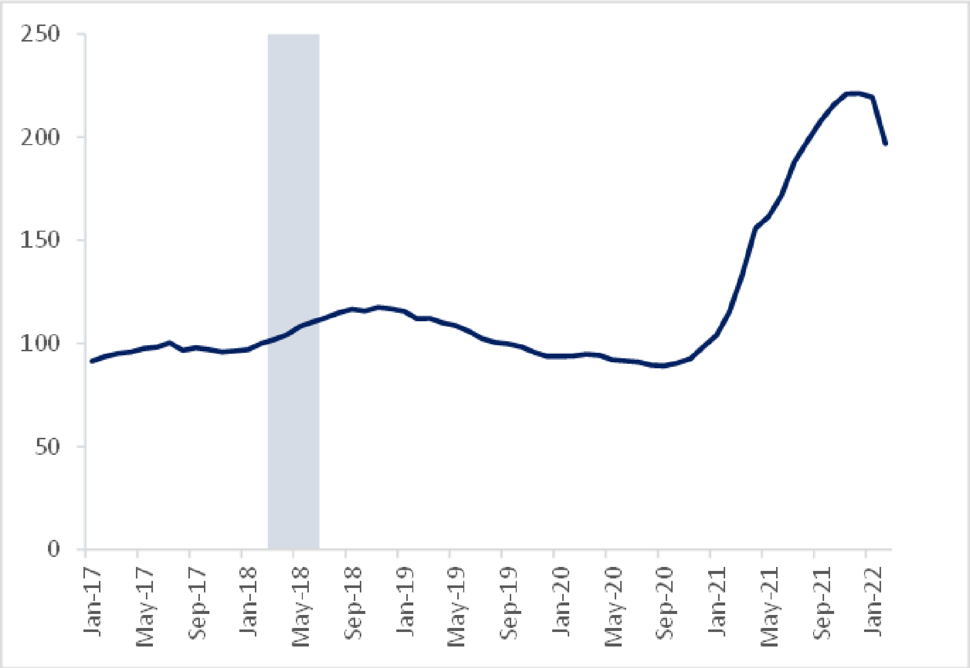


- Additional 16% tariff is put on US firms and households that purchased $506 billions of Chinese goods in 2021.
- Removal of these tariffs will...
  - save $81 billion
  - reach tariff-equivalent reduction of 2.9 pp on all US imports

Source: Chad P. Bown, US-China Trade War Tariffs: An Up-to-Date Chart, PIIE Chart (March 16, 2021, Washington: Peterson Institute for International Economics)

2. Dismantle Trump's 25% Section 232 steel tariffs

Steel price, January 2017 – February 2022, index February 2018 = 100



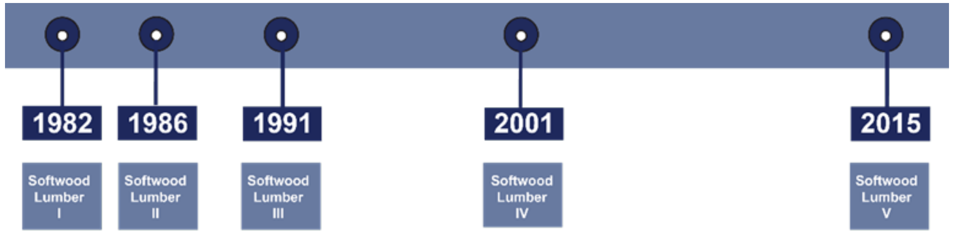
Source: FRED

- On March 1, 2018, Trump announced tariffs of 25% on steel imports following investigations under Section 232 of the Trade Expansion Act of 1962.
- Steel price more than doubled since then.
- Removal of these tariffs will...
  - save $8.5 billion
  - reach tariff-equivalent reduction of 0.3 pp on all US imports

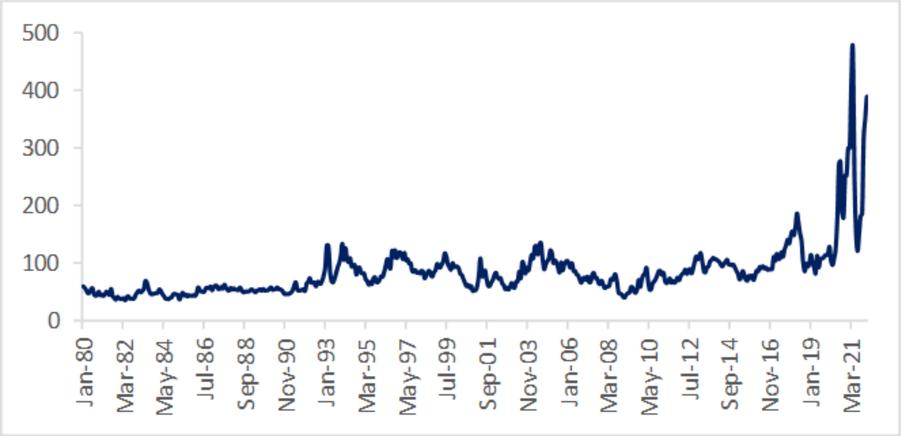
3. Waive penalty duties on Canadian lumber

- 4-decade long lumber disputes with Canada
- In November 2021, US doubled duties on Canadian lumber to 18%.
- “Unprecedented spikes” in lumber prices have added $36,000 to average new single-family home
- Removal of these duties will...
  - save $33 million

  (but note that as recent as 2017, US imports of Canadian lumber was $5.9 billion, that dropped to $185 million in 2021)



Source: Library of Parliament



US lumber spot price, January 1980 – February 2022, index Nov 2021 = 100
Source: Natural Resources Canada

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4. Relax Buy America rules

- Strict Buy America rules exclude foreign competitors from US government procurement
- These rules cost the US government about $100 billion annually
- Relaxing the rules will...
  - save $25 billion
  - reach tariff-equivalent reduction of 0.9 pp on all US imports

Indicator	United States
1. Imports of goods and services	7.5 percent of government procurement (2014)
2. Imports of goods and services	15.0 percent of GDP (2017)
3. Total value of government procurement	1,809.4 billions of dollars (2017)
4. Observed level of procurement imports	135.9 billions of dollars (2017)
5. Free trade level of procurement imports	203.6 billions of dollars (2017)
6. Observed level of domestic procurement	1,673.5 billions of dollars (2017)
7. Estimated markup on domestic production	5.6 percent
8. Estimated ad valorem equivalent (AVE) tariff rate	26.0 percent

Source: Gary Clyde Hufbauer and Euijin Jung, The high taxpayer cost of "saving" US jobs through "Made in America", Trade and Investment Policy Watch (August 5, 2020, Washington: PIIE)

5. Cap “peak tariffs” at 10 percent

- The US imposed “peak tariffs” of 20% or more in 2021 on $21 billion of imports from countries other than free trade agreement partners.
- Clothing, footwear, and dairy products, all staples for low-income Americans, were hit hard.
- Assuming "peak tariffs" to average about 30% and capping them at 10% will...
  - save $4 billion
  - reach tariff-equivalent reduction of 0.14 pp on all US imports

Other measures considered

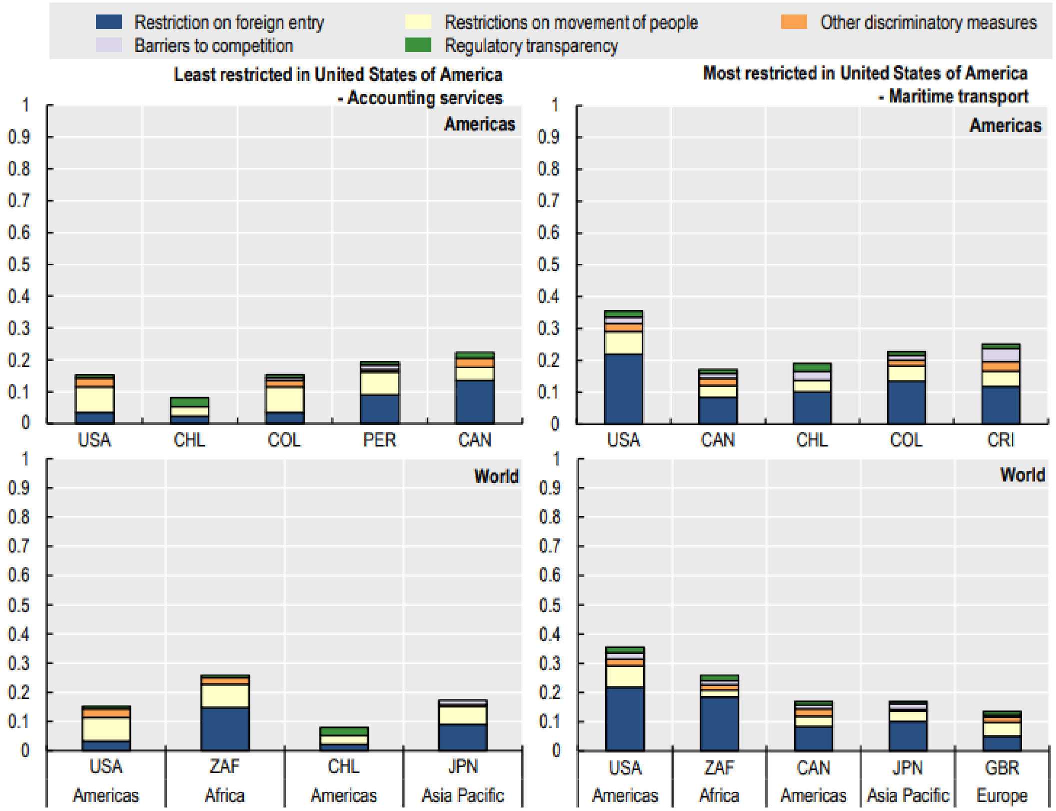
- Renew GSP and waive the Competitive Need Limit
  - GSP expired on December 31, 2020
  - The Competitive Need Limit is now stipulated as $195 million
  - Waving this quantitative ceiling will save Americans $2.4 billion

- Waive penalty duties on Moroccan potash fertilizer
  - The US imposes 20% duties on fertilizer imports from Morocco
  - Waving this duty will save $140 million

Other measures considered

- Waive the Jones Act for Hawaii and Puerto Rico
  - By requiring ships that serve US coastal trade to be made in US shipyards and manned by US citizens, the Act more than doubles the cost of moving containers.
  - Waving the act will save an average Hawaiian family $1,800 and each family in bankrupt Puerto Rico about $500

United States compared to the Americas and World's best performers



Source: OECD Services Trade Restrictiveness Index (STRI) report (2021)

Recap

Specific tariff reduction measures

1.	Eliminate Trump's trade war tariffs	2.9 percentage point tariff-equivalent reduction, corresponding to 0.3 percentage point reduction in CPI inflation	0.96 percentage point reduction in CPI inflation (Robinson and Thierfelder's 1.3 percentage points[a] minus 0.3 percentage point [direct effect item (1)] minus 0.04 percentage point [direct effect item (2)]; direct effect of item (3) is negligible and thus not factored in here)	1.3 percentage point reduction in CPI inflation
2.	Dismantle Trump's 25 percent Section 232 "national security" steel tariffs	0.3 percentage point tariff-equivalent reduction, corresponding to 0.04 percentage point reduction in CPI inflation		
3.	Waive penalty duties on Canadian lumber	Saving of $33 million		

Recap

4.	Relax Buy America rules	0.9 percentage point tariff-equivalent reduction, corresponding to 0.1 percentage point reduction in CPI inflation	0.5 percentage point reduction in CPI inflation (0.9 percentage point tariff-equivalent reduction * 0.67 [Robinson-Thierfelder coefficient] – 0.1 percentage point [direct effect]).	0.6 percentage point reduction in CPI inflation
5.	Cap “peak tariffs” at 10 percent	0.14 percentage point tariff-equivalent reduction, corresponding to 0.02 percentage point reduction in CPI inflation	0.07 percentage point reduction in CPI inflation (0.14 percentage point tariff-equivalent reduction * 0.67 [Robinson-Thierfelder coefficient] – 0.02 percentage point [direct effect]).	0.09 percentage point reduction in CPI inflation
6.	Renew GSP and waive the Competitive Need Limit	Saving of $2.4 billion		
7.	Waive penalty duties on Moroccan potash fertilizer	Saving of $140 million		
	Total	**4.2 percentage point tariff-equivalent reduction, corresponding to 0.5 percentage point reduction in CPI inflation**	**1.5 percentage point reduction in CPI inflation**	**2.0 percentage point reduction in CPI inflation**

Conclusion

- Altogether, the eight measures could result in a tariff-equivalent reduction of 4.2 pp, far exceeding the 2.0-pp goal we set out in our policy brief.
- That 4.2 pp tariff-equivalent reduction could eventually translate to 2.0 pp reduction in CPI inflation.
- These examples are illustrative. Each action will inevitably face political pushback.

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