The Effect of President Trump's Tariffs on the Inland Empire Economy

by

Manfred Keil and Robert Kleinhenz[1]

This is the 6th version of the piece we wrote originally after April 2nd, when President Trump announced the "reciprocal tariffs" in the Rose Garden of the White House. The current version was updated after the president's tweet on April 9 that he would implement a 90-day pause for the reciprocal rates, with the exception of China, the third largest trading partner of the U.S., which now faces a tariff of 145 percent. Although Treasury Secretary Scott Bessent said that "This was the strategy all along," the sudden changes in policy have been unpredictable and added to uncertainty about future policies, making it difficult to extract the signal from the noise and decipher how the economy will fare going forward. Given the subsequent drop in the Dow Jones on April 10, we are clearly not the only ones who are worried about increased uncertainty.

On April 2, labeled "Liberation Day" by President Trump and "Ruination Day" by *The Economist* Magazine, we learned that "reciprocal" tariffs on a large number of countries in the world will be put into place almost immediately. Of greatest relevance to Southern California and the Inland Empire are the tariffs that apply to countries in Asia, which ship most of their exports into the United States through the Ports of Los Angeles and Long Beach. Vietnam, for example, was supposed to have faced a tariff of 46 percent, South Korea 25 percent, and Japan 24 percent.

The initial announcement caused stock prices to fall by amounts hardly seen before historically, and certainly not following policy announcements by the federal government. The Dow Jones Industrial Index declined by over 9 percent or over 3,950 points over two trading days, deleting $6,000,000,000,000 of wealth in just two days. There was little doubt that price levels in the U.S. would rise as a result. This would generate further economic problems, for example, delaying rate cuts by the Federal Reserve that would help to stimulate housing starts and activity in other interest sensitive sectors of the economy.

Here in the Inland Empire and the rest of Southern California, tariffs will affect the Logistics sector most directly, with ripple effects on firms throughout the supply chain and the general economy. For example, inbound goods from China make up a significant portion of business at the Port of Long Beach, so even a modest reduction in the flow of Chinese imports can cause job losses through the entire import/export supply chain. Of course, the merchants and other businesses that take delivery of the imports will face higher prices on the goods they receive. Moreover, while

[1] Keil: Chief Economist, Inland Empire Economic Partnership, Associate Director, Lowe Institute of Political Economy, Robert Day School of Economics and Finance, Claremont McKenna College. Kleinhenz: CEO Kleinhenz Economics, Director, Office of Economic Research, California State University Long Beach.

some manufacturers with facilities in more than one country may have the ability to shift production from one country to another to limit exposure to tariff increases others do not. If any or all of these links in the import supply chain are disrupted by tariffs, the Logistics industry in the Inland Empire and elsewhere in Southern California may be adversely affected, with negative consequences for industry employment and the region's warehouse sector. San Bernardino County faces the greatest risk, as one in five jobs across the county are currently associated with logistics.

It is difficult at this point to estimate the impact of higher tariffs because they have not yet been finalized, but it is important to understand how tariffs will affect the prices consumers and businesses face on imported goods. As a simple example, suppose a pair of shoes that sells at a retail price of $60 is manufactured in a country that faces a 10 percent tariff. The tariff itself is not imposed on $60 but on the price of the shoes when they enter the country. If the import price is $20, then the 10 percent tariff raises the effective import price to $22. It is impossible to know how much of the tariff may be passed along in the final price of the shoes, but suppose the entire amount is passed along. Then, the price of shoes will become $62, a 3.3% increase. In other words, the final sales prices of imported goods will increase by less than the full 10 percent tariff.

The point is that while tariffs will make imports more expensive, the prices end users pay will go up by a smaller percentage than the tariff rates themselves. Moreover, U.S. expenditures on imports is equivalent to 11% of GDP, so the impact of tariffs on prices and overall economic activity will be more modest than not. It will certainly have less of an effect on the U.S. than on the exporting country, where exports often have a higher share of national output.

It is premature to offer a full quantitative assessment of the impact of tariffs on the Inland Empire Logistics industry and economy at this stage. A full-scale trade war would wreak havoc on the the industry, with adverse ripple effects through the area's economy. Nevertheless, as the example above illustrates, if the new tariff regime settles at an average tariff rate of 10%, the adverse effects will be more muted, meaning some job losses and other adjustments in the Logistics sector, but large-scale job losses would be unlikely, as would a broader regional downturn. In addition, consumers may change spending patterns because of the higher prices, and instead purchase goods or services that are not impacted by the tariffs, since they have now become relatively cheaper.

Having said that, tariffs are not the only reason for the current level of uncertainty. Recent and expected policy shocks relating to immigration, government spending and institutions, and the tax code have caused a significant increase in uncertainty about the future direction of policy and the overall economy. It is this more widespread sense of uncertainty that puts the economy at risk of a recession and the Inland Empire at risk of a regional downturn.