**CONGRESSIONAL BUDGET OFFICE**
***U.S. Congress***
***Washington, DC 20515***

***Phillip L. Swagel, Director***

December 18, 2024

Honorable Chuck Schumer
Majority Leader
United States Senate
Washington, DC 20510

Honorable Sheldon Whitehouse
Chairman
Committee on the Budget
United States Senate
Washington, DC 20510

Honorable Ron Wyden
Chairman
Committee on Finance
United States Senate
Washington, DC 20510

*Re: Effects of Illustrative Policies That Would Increase Tariffs*

Dear Leader Schumer, Chairman Whitehouse, and Chairman Wyden:

You asked about the budgetary, economic, and distributional effects of policies that would raise tariff rates on goods imported into the United States. Specifically, you asked the Congressional Budget Office to estimate the effects of permanently increasing the existing rates of duty on imports from all countries by the equivalent of 10 percent of the value of goods and the effects of permanently increasing the existing rates of duty on imports from China by 60 percent of the value of goods. You also asked CBO to estimate the effects of combining those two policies—a 60 percent tariff on imports from China and a 10 percent tariff on imports from the rest of the world. In each case, the increased tariffs would apply to all goods imported after December 31, 2024, including imports that are currently subject to a zero percent duty rate and imports from partners in current trade agreements.

I am writing with our preliminary assessment of the effects of higher tariffs under those policies.

**Budgetary Effects**

CBO estimates that each of the policies would increase federal receipts from customs duties. The policies also would reduce U.S. imports and, consequently, reduce customs user fees. Those fees are recorded in the budget as offsetting receipts (that is, negative outlays). Thus, the reduction in such fees would result in a small increase in federal outlays. The net result of those two effects would be a decrease in the deficit.

Under the long-standing convention of holding the size of the economy unchanged when estimating budget effects, CBO estimates that the policies would have the following effects over fiscal years 2025 to 2034:

- A uniform increase in tariffs of 10 percent of the value of goods would decrease deficits by $2.2 trillion.

- An increase in tariffs of 60 percent of the value of all goods imported from China would decrease deficits by $0.8 trillion.

- The combination of a uniform increase in tariffs of 10 percent plus an additional 50 percent on goods imported from China would decrease deficits by $2.9 trillion.

Under the rules of the House of Representatives, those policies would be considered major legislation. When practicable, estimates of the cost of major legislation must incorporate the budgetary effects of changes in economic output, employment, capital stock, and other macroeconomic variables. After incorporating those economic effects, estimates of the budgetary effects of the policies over fiscal years 2025 to 2034 are as follows:

- A uniform increase in tariffs of 10 percent of the value of goods would decrease deficits by $2.1 trillion.

- An increase in tariffs of 60 percent of the value of all goods imported from China would decrease deficits by $0.7 trillion.

- The combination of a uniform increase in tariffs of 10 percent plus an additional 50 percent on goods imported from China would decrease deficits by $2.7 trillion.

Those estimates are preliminary and are relative to CBO's economic and budget baseline projections from June 2024.[1] The reduction in deficits would result almost entirely from decreases in primary deficits (that is, deficits excluding net outlays for interest on the public debt). The estimates reflect CBO's expectation that an increase in tariffs by the United States would prompt other countries to retaliate with equivalent tariffs on exports from the United States.

## Economic Effects

CBO expects that the increases in tariffs on U.S. imports and matching tariffs imposed by trading partners on U.S. exports in retaliation would reduce the size of the economy in relation to CBO's baseline projections. CBO further expects that the increases in tariffs would make consumer goods and capital goods (physical assets that businesses use to produce goods and services) more expensive. Those increases in costs would put upward pressure on inflation over the first few years in which the tariffs were in place.

**Effects on the Size of the Economy.** The proposed changes in tariffs would affect U.S. economic activity in several ways:

- They would make consumer goods and capital goods more expensive, thereby reducing the purchasing power of U.S. consumers and businesses.

- They would increase businesses' uncertainty about future barriers to trade and would reduce returns on new investments, especially for businesses that use imported goods in their production process. As a result, some U.S. businesses would delay or forgo new investments. In addition, by increasing the cost of operations, tariffs might encourage businesses to make costly adjustments to their supply chains.

- They would reduce productivity by limiting competition from imports and causing resources to be used less efficiently than they otherwise would have been used.

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[1] Congressional Budget Office, *An Update to the Budget and Economic Outlook: 2024 to 2034* (June 2024), www.cbo.gov/publication/60039. For more information about how CBO projects tariff revenues, see Congressional Budget Office, "How CBO Projects Tariff Revenues" (October 2024), www.cbo.gov/publication/606926.

- They would prompt retaliatory tariffs by U.S. trading partners, which would reduce U.S. exports by making them more expensive for foreign purchasers.

All of those effects would lower U.S. output. In the other direction, U.S. consumers and businesses would replace certain imported goods with goods produced in the United States, which would offset some of that decline in output.

The increase in duties collected from the higher tariffs would also reduce the budget deficit. The resulting reduction in federal borrowing would increase the funds available for private investment, thereby increasing output and offsetting a significant portion of the output-reducing effects described above. That effect would be strongest for the two policies that involve a uniform increase in tariffs of 10 percent of the value of goods. For both of those policies, the reduction in real (inflation-adjusted) output before accounting for that effect is nearly twice as large as the net effect reported below. In other words, for those two policies, the increase in the funds available for domestic investment resulting from lower budget deficits provides a substantial offset to the agency's estimate of how much those tariffs reduce real output.

CBO estimates that on net, the policies would have the following effects on real gross domestic product (GDP) in 2034:

- A uniform increase in tariffs of 10 percent of the value of goods would decrease real GDP by 0.3 percent.

- An increase in tariffs of 60 percent of the value of all goods imported from China would decrease real GDP by 0.3 percent.

- The combination of a uniform increase in tariffs of 10 percent plus an additional 50 percent on goods imported from China would decrease real GDP by 0.6 percent.

Those estimates of the effects of the changes in tariffs on real output are within the range of estimates from other economic analyses.[2]

**Effects on Prices.** In CBO's assessment, the tariff policies and the associated retaliation by U.S. trading partners would lead to increases in consumer prices. The changes in tariffs would raise the cost of imported goods. Prices for foreign and domestic substitutes would also rise as consumers and businesses replaced imports that were subject to tariffs with those substitutes. In addition, tariffs on inputs used by domestic businesses would lead to higher prices for the goods and services that they sell.

The changes in tariffs would partially offset that upward pressure on domestic prices in two ways. First, the changes would cause the value of the dollar to rise in foreign exchange markets, which would dampen the increase in the cost of imported goods and reduce the cost of some imported services. For example, a stronger dollar would reduce the price of foreign travel. Second, retaliatory tariffs would drive down the prices of some domestically produced goods in export-oriented industries. In particular, by reducing foreign demand for agricultural exports, retaliatory tariffs would lead to lower prices for certain food products.

CBO estimates that on net, by 2026, the policies would have the following effects on prices as measured by the price index for personal consumption expenditures (PCE):

- A uniform increase in tariffs of 10 percent of the value of goods would increase the level of the PCE price index by roughly 0.6 percent.

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[2] For example, see Erica York, "Revenue Estimates of Trump's Universal Baseline Tariffs" (Tax Foundation, blog entry, November 6, 2024), https://tinyurl.com/3f377cst; The Budget Lab, *Fiscal, Macroeconomic, and Price Estimates of Tariffs Under Both Non-Retaliation and Retaliation Scenarios* (October 16, 2024), https://tinyurl.com/8ydenrb5; International Monetary Fund, *World Economic Outlook: Policy Pivot, Rising Threats* (October 2024), Box 1.2, https://tinyurl.com/52vthpzm; Warwick McKibbin, Megan Hogan, and Marcus Noland, *The International Economic Implications of a Second Trump Presidency*, Working Paper 24-20 (Peterson Institute of International Economics, September 2024), https://tinyurl.com/yd8hdkfj; Committee for a Responsible Federal Budget, "Donald Trump's 60% Tariff on Chinese Imports" (blog entry, April 10, 2024), https://tinyurl.com/4ry8cw7z; and Committee for a Responsible Federal Budget, "Donald Trump's Universal Baseline Tariff" (blog entry, September 11, 2023), https://tinyurl.com/3f29zevb.

- An increase in tariffs of 60 percent of the value of all goods imported from China would increase the level of the PCE price index by roughly 0.4 percent.

- The combination of a uniform increase in tariffs of 10 percent and an additional 50 percent on goods imported from China would increase the level of the PCE price index by roughly 1 percent.

CBO expects that after 2026, the tariffs would not have additional significant effects on prices.

**Distributional Effects**

The tariffs would reduce average real income by decreasing aggregate output and raising prices, but the effects on income would not be the same for all households. The effect on income from changes in output would depend in part on the industries in which workers in different households were employed. Industries that produce goods that compete with imports would probably expand, whereas industries that chiefly produce exports or source a large share of their production inputs from abroad would probably contract. Workers in expanding industries may see their income grow, and workers in contracting industries would probably see their income decline.

The extent to which changes in prices affected households' purchasing power would also vary. Tariffs tend to put more upward pressure on the prices of goods than on the prices of services. Because households at the lower end of the income distribution spend a greater share of their income on goods, they would experience the largest declines in purchasing power. CBO is still evaluating how higher prices from tariffs would affect households across the income distribution.

Finally, the effects of the tariffs on households would depend on each household's level of wealth and the types of assets they hold. The dollar value of U.S. holdings of foreign assets would likely decrease because changes in tariffs would increase the value of the dollar in foreign exchange markets. That reduction in U.S. wealth would likely be concentrated at the top end of the income distribution.[3]

[3] For a detailed discussion, see Dorian Carloni, *How Nominal Foreign Currency Depreciation Against the U.S. Dollar Affects U.S. Wealth*, Working Paper 2018-05 (Congressional Budget Office, June 2018), www.cbo.gov/publication/53931.

**Basis of the Estimates**

To estimate the effects of changes in tariff rates, CBO first collects data on current imports of products that would be affected by the new rates. Next, the agency uses its macroeconomic forecast of imports to project imports of those products under current law. Then, CBO estimates how U.S. trade flows would respond to changes in tariff rates by using elasticities drawn from empirical research that describe the sensitivity of import flows to changes in tariff rates over time.[4] After calculating the effect of tariffs on imports, the agency uses the new tariff rates to estimate future revenues. That estimate of revenues is then reduced to account for the changes in income and payroll taxes that are projected to result.[5] Finally, the estimated revenues under the new tariff rates are compared with revenues projected under current law.

To estimate the effects of higher tariffs on output, investment, and productivity over the next decade, CBO further assessed how the tariffs would change the costs of production for businesses, the incentives for those businesses to invest in new capital, and the efficiency with which productive resources are allocated across industries by using the Global Trade Analysis Project (GTAP) model.[6] The agency also accounted for how those tariffs would reduce federal borrowing and, as a result, would increase the resources available for private investment. In addition, the estimates reflect how the tariffs would alter the overall demand for goods and services in the short term.

CBO's estimates of the economic effects of tariffs also reflect how tariffs would affect the prices consumers and businesses pay for goods and services. To estimate price changes, the agency translates changes in production costs across industries into changes in the prices of goods and services, accounting for industries' dependence on one another.[7] (A given industry's product uses other industries' products as inputs; the price of the

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[4] Christoph E. Boehm, Andrei A. Levchenko, and Nitya Pandalai-Nayar, "The Long and Short (Run) of Trade Elasticities," *American Economic Review*, vol. 113, no. 4 (April 2023), pp. 861–905, https://doi.org/10.1257/aer.20210225.

[5] Congressional Budget Office, *CBO's Use of the Income and Payroll Tax Offset in Its Budget Projections and Cost Estimates* (October 2022), www.cbo.gov/publication/58421.

[6] For more information about the GTAP model, see Erwin L. Corong and others, "The Standard GTAP Model, Version 7," *Journal of Global Economic Analysis*, vol. 2, no. 1 (2017), pp. 1–119, https://doi.org/10.21642/JGEA.020101AF.

[7] CBO used the Bureau of Economic Analysis's Input-Output Accounts Data for 2023 to estimate those price effects. See www.bea.gov/industry/input-output-accounts-data.

industry's product therefore reflects production costs not only in that industry but also in other industries.) The estimates of the effects of tariffs on prices also reflect estimated changes in prices resulting from the higher exchange value of the dollar.

Finally, CBO used its budgetary feedback model to estimate how economic changes stemming from higher tariffs would affect federal spending and revenues.[8] That model approximates the estimates that CBO would produce with the wider suite of models that it uses to conduct dynamic analyses of legislative proposals.

**Uncertainty**

The United States has implemented no increases in tariffs of this size in more than 50 years, so there is little relevant empirical evidence on their effects. As a result, CBO's estimates of the economic effects of large changes in tariffs are very uncertain. Nevertheless, the direction of the estimated effects is consistent with previous experience. The actual effects would depend on how businesses and consumers in the United States and other countries responded to the higher tariffs and the extent to which foreign governments responded with higher tariffs on U.S. exports. The estimates reported above reflect the expectation that U.S. trading partners would respond to the increases in tariffs with retaliatory increases of a similar magnitude.

CBO's analysis of the effects of increases in tariffs is preliminary, and the agency continues to refine how it models the economic and distributional effects of such changes.

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[8] For a detailed discussion, see Nathaniel Frentz and others, *A Simplified Model of How Macroeconomic Changes Affect the Federal Budget*, Working Paper 2020-01 (Congressional Budget Office, January 2020), www.cbo.gov/publication/55884.

Please contact me if you have additional questions or would like to discuss these topics further.

Sincerely,

Phillip L. Swagel
Director

cc: Honorable Mitch McConnell
Republican Leader

Honorable Chuck Grassley
Ranking Member
Committee on the Budget

Honorable Mike Crapo
Ranking Member
Committee on Finance